

CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 81

**SECURITIES AND EXCHANGE COMMISSION,
PETITIONER**

VS.

CHENERY CORPORATION, ET AL

No. 82

**SECURITIES AND EXCHANGE COMMISSION,
PETITIONER**

VS.

FEDERAL WATER AND GAS CORPORATION

**ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE DISTRICT OF COLUMBIA**

**PETITION FOR CERTIORARI FILED APRIL 8, 1946
CERTIORARI GRANTED MAY 13, 1946**

INDEX TO JOINT APPENDIX.

	Page
Petition for Review of Order of Securities and Exchange Commission (No. 9877)	2
Petition for Review of Order of Securities and Exchange Commission (No. 8978)	14
Excerpts from Original Proceedings before Securities and Exchange Commission	32
Excerpts from Testimony (July 22 and 23, 1940) ..	34
Christopher T. Chenery	34, 53, 60
Walter A. Culin	48
Roscoe C. Ingalls	57
Howard M. Erskine	71
Exhibits:	
Applicant's Exhibit No. 33 (Docket No. 81)	79
Applicant's Exhibit No. 36 (Docket No. 84)	83
Excerpt from Exhibit B-96	85
Application of Chenery Corporation, et al. for Leave to Intervene, and Request for Reconsideration and Relief	86
Order Granting Application to Intervene	97
Opinion of the Supreme Court	98
Order on the Mandate of the Supreme Court	104
Excerpts from Supplementary Proceedings before Securities and Exchange Commission	118
Application and Declaration of Federal Water and Gas Corporation (filed April 7, 1943)	118
Motion of Intervenors for Further Proceedings Pursuant to Mandate	127
Findings and Opinion of the Commission	128
Order Denying Application and Reapproving Plan	169

Proceedings in United States Court of Appeals for the District of Columbia.....	171
Minute entry of argument and submission.....	171
Opinion, Groner, C. J.....	172
Judgment and decree.....	181
Designation of record.....	182
Clerk's certificate.....	182
Stipulation as to consolidation and as to printed record.....	183
Orders allowing certiorari.....	184

IN THE
United States Court of Appeals

DISTRICT OF COLUMBIA.

No. 8977.

CHENERY CORPORATION, ET AL., *Petitioners,*

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

No. 8978.

FEDERAL WATER AND GAS CORPORATION,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

**Petition for Review of Orders of Securities and Exchange
Commission.**

JOINT APPENDIX

**Petition for Review of Orders of Securities and Exchange
Commission.**

Filed Mar 22 1945

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA**

No. 8977.

CHENERY CORPORATION, H. M. ERSKINE, R. H. NEILSON, ET
AL., *Petitioners,*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

*To the United States Court of Appeals for the District of
Columbia:*

The petition of Chenery Corporation, H. M. Erskine, R. H. Neilson, W. A. Culin, F. T. Tansill, H. D. McHenry, T. H. Wiggin, C. M. Chenery, J. N. Greene, H. G. Calder, C. P. Rather, William E. Matthews, III, C. van den Berg, Jr., W. R. Edwards, Watson Dark, E. C. Deal, F. R. Harris, and E. C. Elliott (hereinafter called "the petitioners"), respectfully represents:

(1)

*The Nature of the Proceedings as to Which Review Is
Sought.*

Petitioners seek review of an order issued by the Securities and Exchange Commission February 7, 1945, in certain proceedings entitled "In the Matter of Federal Water Service Corporation, Utility Operators Company, Federal Water and Gas Corporation, File Nos. 34-9, 34-41, 70-28 (Public Utility Holding Company Act of 1935)." The nature of these proceedings is more fully set forth in Part (2) hereof.

The Facts and Statutes Upon Which Jurisdiction Is Based.

(A) Federal Water Service Corporation, a Delaware corporation (hereinafter called Federal), was a holding company owning securities of subsidiaries which operated water, gas, electric and other properties. November 8, 1937, Federal registered with the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935, and filed with the Commission, pursuant to Section 7 of said act and the rules of the Commission an application for a report on a plan of reorganization, and declarations regarding the alteration of rights of holders of outstanding securities and the solicitation of consents. The application and declarations set forth a plan for the voluntary reorganization of Federal, to be accomplished by amendment to its certificate of incorporation pursuant to Section 26 of the Delaware Corporation Law, and by a reduction in its capital pursuant to Section 28 of the Delaware Corporation Law. At the time of the filing of the application and declarations, Federal had outstanding six classes or series of stock: \$7, \$6.50, \$6, \$4 series preferred stock, Class A stock and Class B stock. Dividends in arrears had accumulated on all series of preferred stock and upon the Class A stock. Federal had valuable assets and had substantial annual net income, but, by reason of earlier losses and depreciation in the value of investments, the corporation had a capital deficit which under Delaware Law prevented the payment of dividends. The directors of Federal desired to simplify its corporate structure and to eliminate the capital deficit by reduction of capital, and thus to enable the corporation to resume the payment of dividends.

(B) The Commission objected to the plan first proposed, new plans were filed, and continued discussions were had with representatives of the Commission toward the development of a plan which the Commission would permit to

4

become effective under the Public Utility Holding Company Act of 1935, which would comply with the Law of Delaware as to the rights of holders of preferred stock to arrears of dividends, and which would also command the necessary consent of the stockholders of Federal as required by Delaware Law. After the decision on January 16, 1940, in *Havender v. Federal United Corporation*, 11 A. (2d) 331, which established that under Delaware Law preferred stock together with dividends in arrears thereon might be converted into new securities through a merger, Federal filed with the Commission on March 30, 1940, amendments to its application and declarations, setting forth a new plan of reorganization by way of merger. These amendments proposed the merger into Federal of two other Delaware corporations, Utility Operators Company and Federal Water and Gas Corporation. Utility Operators Company, the stock of which was largely owned by officers and employees of Federal and its subsidiary companies, owned all of the Class B stock of Federal. Federal owned all of the stock of Federal Water and Gas Corporation. Utility Operators Company and Federal Water and Gas Corporation also filed with the Commission declarations regarding the alteration of the rights of the holders of their securities in accordance with the proposed merger agreement.

(C) During the period from November 8, 1937, to June 30, 1940, the petitioners purchased preferred stock in Federal in amounts as follows:

Name	Shares		
	\$6.00 Preferred	\$6.50 Preferred	\$7.00 Preferred
Chenery Corporation	3860	3547	1211
H. M. Erskine	25	50	—
R. H. Neilson	10	—	—
W. A. Culin	50	110	—
F. T. Tansill	—	65	—
H. D. McHenry	—	75	15
T. H. Wiggin	50	30	—
C. M. Chenery	150	170	—
J. N. Greene	45	—	—
H. G. Calder	—	40	—
C. P. Rather	110	310	—
Wm. E. Matthews, III	—	65	—
C. van den Berg, Jr.	25	1535	140
W. R. Edwards	100	—	—
Watson Dark	5	160	60
E. C. Deal	85	—	—
F. R. Harris	130	173	40
E. C. Elliott	27	—	—

C. M. Chenery sold 125 shares of the \$6.00 preferred stock and 20 shares of the \$6.50 preferred stock, and C. van den Berg, Jr., sold 25 shares of the \$6.00 preferred stock and 700 shares of the \$6.50 preferred stock. When these purchases and sales were made the petitioners other than Chenery Corporation were officers or directors of Federal or of Utility Operators Company. Petitioner Chenery Corporation is a family holding company which had nine stockholders, of whom two, who owned approximately 47% of the stock of Chenery Corporation, were officers or directors of Federal or Utility Operators Company. All of these purchases and sales of stock in Federal were currently reported to the Commission by the purchasers as required by Section 17 of the Public Utility Holding Company Act of 1935.

(D) June 29, 1940, the Commission issued tentative findings in which the question was raised for the first time

whether the preferred stock which had been purchased by officers and directors of Federal or Utility Operators Company and by Chenery Corporation while plans of reorganization were pending before the Commission should be treated on any different basis than other preferred stock. Hearings were had on this question, and testimony was introduced establishing that all such stock had been purchased through brokers in the over-the-counter market at prices prevailing from time to time, except 2700 shares acquired by Chenery Corporation from an investment banking house in exchange for debenture bonds of Federal. A partner of the investment banking house testified that he was fully acquainted with the value of the stock and bonds, and that it had been a most satisfactory trade. C. T. Chenery, the President of Federal, testified that he had advised the purchases of preferred stock of Federal by the Chenery Corporation and by the individual officers and directors, because he believed that the preferred stock was a very good investment, and because by its purchase the management could maintain a voting interest if the B stock should be eliminated.

(E) March 24, 1941, the Commission filed formal findings and an opinion in the proceeding. The plan then under consideration had contemplated the conversion of the four classes of preferred into new common stock. The Commission stated that the plan could not be approved in so far as it provided for participation of the preferred shares purchased by officers or directors of Federal or Utility Operators Company, or by the Chenery Corporation, after November 8, 1937, on a parity with other shares of preferred stock of the same class. The Commission found that "the provisions for participation by the preferred stock held by the management result in the terms of issuance of new securities being detrimental to the interest of investors and the plan being unfair and inequitable." Entry of an order was deferred, and it was stated that further consideration would be given to the matter if Fed-

eral filed amendments to its proposed plan designed to cure this and other alleged defects therein.

(F) Thereafter amendments to the declarations and applications were filed by the corporations in order to present a plan which complied with the findings and opinion of the Commission. The proposed merger agreement was amended to provide among other things that no shares of common stock of the surviving corporation should be issued for the shares of preferred stock of Federal purchased since November 8, 1937, by Chienery Corporation or by the individual petitioners when they were officers or directors of Federal or of Utility Operators Company, but that each such purchaser should receive upon surrender of such stock to the surviving corporation the cost of such stock with interest at 4% per annum from the dates of its purchase to the effective date of the merger agreement. It was further provided in effect that the petitioners should account to the surviving corporation for any profit realized on any such stock as had been sold by them.

(G) August 15, 1941, the petitioners filed an application for leave to intervene in the proceedings before the Commission, and objected to the approval of any plan of reorganization containing a provision to the effect that the preferred stock purchased by the petitioners should be treated on a less favorable basis than other preferred stock of the same class.

(H) August 18, 1941, the Commission ordered that the petitioners be permitted to intervene and become parties to the proceeding, with leave to file a brief.

(I) September 24, 1941, the Commission made a report on the amended plan of reorganization, entered supplemental findings and opinion, and issued an order permitting the declarations, as amended in conformity with the Commission's opinion of March 24, 1941, to become effective, and granting the applications as amended. The effect of

this order was to deny the prayers contained in the intervening petition filed by these petitioners.

(J) October 22, 1941, these petitioners filed a petition in this Court for review of the order of the Securities and Exchange Commission of September 24, 1941, and prayed that said order be modified or set aside to the extent necessary to treat these petitioners on the same basis as other holders of preferred stock of Federal of the same class. The proceedings were given No: 8074 in this Court.

(K) April 27, 1942, this Court entered its opinion holding that there was no regulation of the Commission, no provision of the statute, and no rule of common law or equity prohibiting the purchase of stock by an officer or director while reorganization proceedings were pending, and that the action by the Commission was "neither more nor less than retrospective legislation." An order was entered reversing the order of the Securities and Exchange Commission of September 24, 1941, and remanding the case for further proceedings in conformity with the opinion of the Court.

(L) July 25, 1942, the Securities and Exchange Commission filed a petition for certiorari in the Supreme Court of the United States and certiorari was granted October 12, 1942.

(M) February 1, 1943, the Supreme Court of the United States entered its opinion holding that:

"Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different. . . . But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Con-

gress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11(e), promulgated new general standards of conduct. * * *

"The Commission's action cannot be upheld. * * *

The case was remanded to the Court of Appeals with directions to remand to the Commission for such further proceedings, not inconsistent with the opinion, as might be appropriate. *Securities and Exchange Commission v. Chenery Corporation*, 318 U. S. 80. April 5, 1943, this Court issued an order on the mandate of the Supreme Court directing that the order of the Securities and Exchange Commission be set aside and that the cause be remanded to the Commission for such further proceedings not inconsistent with the opinion of the Supreme Court of the United States as might be appropriate.

(N) Meanwhile the merger contemplated by the Commission's order of September 24, 1941, was completed according to the plan thereby approved, with a provision that no shares of common stock of the surviving corporation should be issued for shares of preferred stock of Federal purchased by the petitioners during the reorganization proceedings. In view of the decision by the Supreme Court of the United States, *Federal Water and Gas Corporation*, the surviving corporation, on April 7, 1943, filed an application and declaration asking leave to submit to its stockholders resolutions providing for an amendment and correction of the merger agreement and for an amendment and correction of the certificate of reduction of capital so as to permit the issue of stock in the surviving corporation to these petitioners on a parity with other preferred stockholders. On the same day these petitioners also filed a motion asking that such further proceedings be had as might be necessary to treat them on the same basis as other

holders of preferred stock of Federal of the same class, and thereafter filed a brief urging that the application filed by the corporation be approved. The matter was argued orally before the Commission on June 17, 1943, on the existing record. No new evidence was introduced. In their brief and argument these petitioners contended that any action by the Commission which did not permit the issue of stock to these petitioners on the same basis as other holders of preferred stock of Federal would be wholly arbitrary, would be retroactive in effect and would constitute an attempt at retrospective legislation, would be unfair, inequitable and detrimental to the public interest and to the interest of investors, would violate the provisions of the Public Utility Holding Company Act of 1935, and would be erroneous and illegal, that the retrospective effect of such action would deprive the petitioners of property without due process of law in violation of the Fifth Amendment of the Constitution, and that such action would be inconsistent with the opinion of the Supreme Court of the United States and in violation of the order issued by this Court.

(O) April 17, 1944, the Commission entered an order denying the application of Federal Water and Gas Corporation. The effect of this order was also to deny the motion of the petitioners that they be treated on the same basis as other holders of preferred stock of Federal of the same class, and to reaffirm the decision of September 24, 1941.

(P) The Commission on June 7, 1944, suspended the effectiveness of the order of April 17, 1944, until further action by the Commission and set the matter down for reargument on June 27, 1944. Reargument was had on the date fixed, these petitioners renewed their objections made at the previous argument, and the Commission took the case under advisement again.

(Q) February 7, 1945, the Commission entered an order again denying the application of Federal Water and Gas Corporation to amend the plan of reorganization, and ordering further that the plan of reorganization theretofore approved by the Commission's order of September 24, 1941, and the transactions contemplated by said plan be reapproved as of September 24, 1941. The effect of this order of February 7, 1945, was again to deny the motion of the petitioners that they be treated on the same basis as other holders of preferred stock of Federal of the same class. With its order of February 7, 1945, the Commission filed a statement of facts and conclusions in which the Commission stated as the basis of its decision:

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to re-examine the case and to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified."

The decision of the Commission was that its previous determination should be reaffirmed.

(R) This Court has jurisdiction to review the said order of February 7, 1945, under Section 24 of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 USCA Sec. 79.

(3)

The Reliefs Prayed.

These petitioners pray that this Court review the order of the Commission of February 7, 1945, and that said order be modified or set aside to the extent necessary to treat these petitioners on the same basis as other holders of preferred stock of Federal of the same class. The petitioners ask such other relief as this Court may deem appropriate.

The Points Upon Which the Petitioners Intend to Rely.

(A) The Commission erred in denying the application of Federal Water and Gas Corporation for leave to submit to its stockholders resolutions providing for an amendment and correction of the merger agreement and for an amendment and correction of the certificate of reduction of capital, so as to permit the issue of stock in the surviving company to these petitioners on the same basis as other holders of preferred stock of Federal of the same class, and the Commission erred in not approving said application, and in not permitting the declaration filed therewith to become effective.

(B) The Commission erred in reapproving those provisions of the amended plan of reorganization previously approved by the Commission's order of September 24, 1941, which provided that the preferred stock of Federal purchased by these petitioners since November 8, 1937, should be treated on a different basis from preferred stock of Federal of the same class held by other stockholders.

(C) The action taken by the Commission is wholly arbitrary; it is retroactive in effect and constitutes an attempt at retrospective legislation; it is unfair, inequitable and detrimental to the public interest and to the interest of investors; it violates the provisions of the Public Utility Holding Company Act of 1935, and it is erroneous and illegal. Its retrospective effect deprives the petitioners of property without due process of law in violation of the Fifth Amendment of the Constitution.

(D) The action taken by the Commission in reaffirming its previous determination, and in reapproving its order of September 24, 1941, is inconsistent with the opinion of the Supreme Court of the United States, and is in violation of the order issued by this Court directing that the order of the Commission of September 24, 1941, be set aside and

remanding the cause to the Commission for further proceedings not inconsistent with said opinion.

Respectfully submitted,

CHENERY CORPORATION,

H. M. ERSKINE,

R. H. NEILSON,

W. A. CULIN,

F. T. TANSILL,

H. D. MCHENRY,

T. H. WIGGIN,

C. M. CHENERY,

J. N. GREENE,

H. G. CALDER,

C. P. RATHER,

WILLIAM E. MATTHEWS, III,

C. VAN DEN BERG, JR.,

W. R. EDWARDS,

WATSON DARK,

E. C. DEAL,

F. R. HARRIS, and

E. C. ELLIOTT,

By SPENCER GORDON,

Attorney.

SPENCER GORDON,

VIRGINIA C. DUNCOMBE

Provington, Burling, Rublee,

Acheson & Shorb

Union Trust Building

Washington 5, D. C.

Attorneys for Petitioners.

Petition for Review of Order of Securities and Exchange Commission.

Filed March 22 1945

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA**

No. 8978.

FEDERAL WATER AND GAS CORPORATION, *Petitioner*,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*.

*To the United States Court of Appeals for the District of
Columbia:*

The petition of FEDERAL WATER AND GAS CORPORATION
(hereinafter called Petitioner) respectfully represents:

*1. The Nature of the Proceedings as to which
Review is Sought.*

Petitioner seeks review of that part of an order of the Securities and Exchange Commission issued on February 7, 1945, which denied an application and declaration of petitioner filed on April 7, 1943 in certain proceedings before the Commission entitled "In the Matter of Federal Water Service Corporation, Utility Operators Company, Federal Water and Gas Corporation, File Nos. 34-9, 34-41, 70-28,

Public Utility Holding Company Act of 1935." Petitioner's application and declaration was filed with the Commission following the remand to the Commission of the cause in this Court entitled "Chenery Corporation, et al, Petitioners v. Securities and Exchange Commission, Respondent, Federal Water and Gas Corporation, Intervenor, No. 80-74". That cause was brought to this Court pursuant to Section 24 of the Public Utility Holding Company Act of 1935 by Chenery Corporation, et al to review an order of the Securities and Exchange Commission entered in the proceedings before the Commission above referred to on September 24, 1941 and which order over the objections of Chenery Corporation, et al approved a merger agreement between Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation and permitted the same to be submitted to stockholders. The merger agreement at the direction of the Commission contained a provision discriminating against preferred stock owned by Chenery Corporation, et al and, instead of allowing such stock to be converted into the stock of petitioner as the surviving corporation on the same terms as other preferred stock of the same class, required such preferred stock to be surrendered to petitioner upon terms which permitted them to receive their cost of all preferred stock purchased after November 8, 1937 with interest at 4% to the effective date of the merger. This Court held that the order of the Commission involved in the cause (which involved only the discriminatory paragraph of the merger agreement) was beyond the power of the Commission and unauthorized by the Public Utility Holding Company Act of 1935 (Chenery Corporation, et al v. Securities and Exchange Commission, 75 App. D. C. 374, 128 F. (2d) 303). On certiorari, the Supreme Court of the United States remanded the cause to this Court with directions to

remand to the Securities and Exchange Commission for such further proceedings not inconsistent with the opinion of the Supreme Court as may be appropriate (*Securities and Exchange Commission v. Chenery Corporation, et al*, 318 U. S. 80). This Court entered its order on the mandate of the Supreme Court on April 5, 1943 setting aside the order of the Commission in the cause and remanding the cause to the Commission as directed by the Supreme Court.

Upon the receipt by the Commission of this Court's order on the mandate, petitioner filed its application and declaration, above referred to, submitting to the Commission proposed resolutions of the Board of Directors of petitioner for the calling of a special stockholders meeting to consider and act upon a proposed amendment to the merger agreement. The amendment struck out the discriminatory paragraph of the merger agreement submitted to the stockholders of the constituent companies on September 26, 1941 and in lieu thereof substituted a paragraph providing for the conversion of the outstanding shares of preferred stock of Federal Water Service Corporation owned by Chenery Corporation, et al into shares of stock of petitioner as the surviving corporation so that they would receive the stock of petitioner upon the same terms as others. The resolutions also proposed to correct the certificate of reduction of capital so as to bring it into conformity with the increase in the amount of stock to be issued in pursuance of the amendment. Contemporaneously with the filing by petitioner of its application and declaration, Chenery Corporation, et al moved the Commission that such further proceedings be had as may be necessary to treat them on the same basis as other holders of preferred stock of Federal Water Service Corporation of the same class. The Commission set petitioner's application and declaration and the motion of Chenery Corporation, et al down for hearing on June 17, 1943. The matters were argued on the original record which was before this Court and the Supreme Court supplemented by the record

of the court proceedings, petitioner's declaration and application and the motion of Chenery Corporation, et al. No testimony was taken.

On April 17, 1944, the Commission issued an order with accompanying findings and opinion denying petitioner's application. The findings and opinion of the Commission contained numerous unjustified statements of fact and opinion. C. T. Chenery, personally, objected strongly to such statements and the Commission, on June 7, 1944, of its own motion issued an order reopening the proceedings for reargument and suspending the effectiveness of the order of April 17, 1944 until further action by the Commission. The reargument was held on the day set.

On February 7, 1945 the Commission entered its order with accompanying findings and opinion again denying petitioner's application to amend the plan of reorganization.

The findings and opinion of the Commission withdrew the findings and opinion of April 17, 1944 and substituted those of February 7, 1945 therefor. The Commission interpreted the opinion of the Supreme Court as follows:

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to reexamine the case and to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified."

The Commission's conclusion was that its previous determination should be reaffirmed. It stated that it was unable to find that the plan, if amended as proposed, would be "fair and equitable to the persons affected thereby" within the meaning of Section 11(e) of the Act; that the plan would involve the issuance of securities on terms

"detrimental to the public interest and the interest of investors" forbidden by Sections 7(d)(6) and 7(e) of the Act, and would result in an unfair and inequitable distribution of voting power within the meaning of the latter section.

2. The Facts and Statutes upon which Jurisdiction is Based.

In addition to the facts above set forth, petitioner also refers to the following:

Petitioner was organized under the Laws of Delaware in 1926 under the name Federal Water Service Corporation. Utility Operators Company was organized under the Laws of Delaware in 1931 and by transactions with Central Hanover Bank and Trust Company in 1932 and with The Chase National Bank of the City of New York in 1934 acquired all of the Class B stock of Federal Water Service Corporation at a cost of \$605,249. The stock of Utility Operators Company was owned by officers and employees of Federal Water Service Corporation and its subsidiary companies.

At all times since the acquisition of the Class B stock of Federal by Utility Operators Company a majority of the Board of Directors of Federal have not been officers of Federal or any of its subsidiary companies and have not been interested in Utility Operators Company.

Federal Water Service Corporation suspended dividends on any class of stock in 1931 and until about 1936 the income which it was able to take down from its subsidiaries was insufficient to enable it to pay dividends on any class of stock.

In 1936 conditions had improved so that the company had current earnings which it could use to pay dividends on its preferred stock but under the Delaware Corporation Law (Section 34), the directors of Federal could not declare dividends as the value of its assets was less than the capital represented by the shares of stock entitled to a

preference on the distribution of assets. Accordingly, consideration was given to a plan to reduce the capital of the corporation so as to permit the payment of dividends and to reclassify the stock of the corporation so as to bring its capital structure into line with assets and earnings.

By reason of the fact that part of the income of subsidiaries of Federal was derived from the retail distribution of electricity and gas, Federal became subject to the requirements of the Public Utility Holding Company Act of 1935. The proportion of such income compared with the income derived from water operations and natural gas pipe-line operations was so small that Federal applied for an exemption under the Public Utility Holding Company Act pursuant to Section 3(a)(3) of the Act. While this application was pending undetermined, it having been filed in good faith, Federal was not required to register under the Act. It submitted to its stockholders in October, 1936, a plan of recapitalization under Section 26 of the Delaware Corporation Law which reclassified its preferred and Class A stocks together with dividends in arrears into a new Class A stock. This plan had to be withdrawn because after it had been submitted to stockholders, the Supreme Court of Delaware on November 10, 1936 in *Keller v. Wilson & Co., Inc.* 190 Atl. 115, reversed the Chancellor and held that dividends in arrears could not be dealt with in a reclassification proceeding as proposed in the plan.

In 1937 Federal took up with the staff of the Commission the question of reducing the capital of the corporation in order that dividends might be paid on the preferred stock. It was advised that in the opinion of the staff, the Commission would not look with favor upon a reduction of capital because it would reduce the capital represented by the no par value preferred and Class A stocks below the liquidating rights of such stocks. Federal did not believe that this was an adequate reason for preventing it from reducing its capital in order that it might pay dividends on

the preferred stock but it did not desire to press the point if a reclassification plan could also be accomplished which would satisfy the Commission.

After further discussions with the staff as to reclassification plans and after Federal had been informed that the staff considered that a proposed plan of reclassification was within the discretionary power of the Commission to approve, on November 8, 1937, it withdrew its application for exemption, registered under the Act and filed a declaration under Section 7 and an application pursuant to Rule 12E-4 for a report on this plan of reclassification of stock and reduction of capital and a declaration pursuant to Rule 12E-5 as to solicitation of consents.

In April, 1938 Federal was advised by the staff of the Commission that it was not prepared to recommend to the Commission the plan of reorganization that had been filed on November 8, 1937 and Federal filed an alternative plan for the reduction in the capital of the corporation on May 19, 1938, the application for the report with respect to this plan stating that applicant believed that the plan of reorganization described in its application of November 8, 1937 was better for applicant and for all classes of its stockholders, but that it was possible that the Securities and Exchange Commission might determine not to permit the declaration on Form U-7 filed on November 8, 1937 to become effective and in this event applicant desired the Commission to consider and pass upon the alternative plan for the reduction of capital. A hearing was held with respect to this plan on August 5, 1938, but no decision was rendered on the two plans then before the Commission. Nothing further took place after the hearing in August until at a conference with the staff in December, 1938, it seemed as if there could be agreement between the staff and the company with respect to a reclassification plan which could be accomplished under the Laws of Delaware and receive the vote of stockholders. This plan, before it was filed was submitted to the Commission, and upon being ad-

vised that the Commission considered the plan sufficiently meritorious to make appropriate the filing of a formal application for approval thereof, the Commission reserving the right to disapprove the plan if concrete facts developed at the hearing made such disapproval necessary, Federal filed the third plan on May 11, 1939. A hearing was held on this plan on June 1, but adjourned because of a decision by the Chancellor in *Havender v. Federal United Corporation*, 6 A. (2d) 618, rendered on June 2, 1939, which made the plan impracticable until the law of Delaware was clarified. The Commission refused to adjourn the hearings on the third plan until an expected appeal in the *Havender* case was decided, and the capital reduction plan was reinstated on August 9, 1939, hearings being completed with respect to this plan on August 31, 1939. No decision was rendered by the Commission, and on January 16, 1940 the *Havender* case was reversed by the Supreme Court of Delaware, which held that a corporation by merger with a wholly-owned subsidiary could deal with arrears in dividends under Section 59 of the Delaware Corporation Law in a manner not permitted by *Keller v. Wilson & Co.* in a reclassification proceeding under Section 26 of the Delaware Corporation Law. *Federal United Corporation v. Havender*, 11 A.(2d) 331.

On March 30, 1940, Federal amended its application which was on file with the Commission pursuant to Rule 12E-4 and its declaration under Rule 12E-5 with respect to the capital reduction plan and requested the Commission's report on a proposed merger between Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation (File No. 34-9). Federal Water Service Corporation and Utility Operators Company at the same time filed a joint declaration with respect to the merger plan under Section 7 (File No. 70-28) and Utility Operators Company filed an application pursuant to Rule 12E-4 for a report and a declaration pursuant to Rule 12E-5 as to solicitation of consents (File No. 34-41).

Chenery Corporation and certain individuals who were officers or directors of Utility Operators Company or Federal Water Service Corporation purchased preferred stock of Federal Water Service Corporation on the open market during the period from November 8, 1937 to January 10, 1940. These purchases for the period from November 9, 1937 to May 11, 1939 were included in the list of purchases and sales by officers and directors filed with the application pursuant to Rule 12E-4 on May 11, 1939 and the purchases from May 12, 1939 to March 30, 1940 were included in the list filed with the application of March 30, 1940. On June 10, 1940 Chenery Corporation acquired 2700 shares of preferred stock by private negotiation with an investment banking house.

Reports as to all purchases and sales were also made to the Commission on the forms prescribed by the Commission pursuant to Section 17 of the Public Utility Holding Company Act.

On June 29, 1940, the Commission issued its tentative findings and opinion as to the merger plan. It suggested the possibility that preferred stock which had been purchased by Chenery Corporation and individuals who were officers or directors of Federal or Utility Operators Company might not be permitted to share in the reorganization upon the same basis as other preferred stock. The findings and opinion referred to *Pepper v. Litton*, 308 U. S. 295 and *In re Norcor Mfg. Co.*, 109 F. (2d) 407, and said:

"While it may be that the facts in the present case differ sufficiently from those in the *Norcor* case, *supra*, to render inapplicable here the principles there applied, we do not regard the question as entirely free from doubt."

In a footnote, it was stated:

"It should be borne in mind that here, as is frequently the case, the discretion and judgment of the management is, as a practical matter, largely determinative not only of

what kind of a plan of voluntary reorganization shall be proposed but of when it shall be proposed."

Hearings were held on July 22, July 23 and July 24, 1940 to take testimony with respect to officers' and directors' purchases, and the matter was argued on August 22, 1940. The Commission rendered its decision on the merger plan on March 24, 1941, in which it was held that the provisions for participation of the preferred stock by the management result in the terms of issuance of the new securities being detrimental to the interest of investors and the plan being unfair and inequitable. The Commission withheld entry of an order, refusing to permit the declarations to become effective, for a period of thirty days in order that Federal might file amendments to its proposal designed to cure the defects in the plan pointed out. The Commission further stated that its staff would be available for consultation with Federal with respect to the matter of participation of such preferred stock.

In order not to delay the consummation of the reorganization and the reduction in the capital of Federal which would permit the payment of dividends, Federal and Utility Operators Company filed an amendment to the merger agreement providing in substance that the shares of preferred stock of Federal purchased by Chenery Corporation or by officers or directors of Federal or Utility Operators Company since November 8, 1937 and owned by them at the effective date of the merger agreement should upon the merger agreement becoming effective be purchased by the surviving corporation for retirement and such holders should be entitled to receive and the surviving corporation should be obligated to pay on the surrender of certificates for such stock for retirement the actual cost of such stock to the holder together with interest upon such cost of 4% from the date of its or his purchase of such stock to the effective date of the merger agreement. This provision was deemed by the staff to be inadequate to satisfy the

Commission's opinion on March 24, 1941 in that it did not guard against the possibility that Chenery Corporation or the individual stockholders affected by the Commission's opinion might sell their preferred stock before the merger agreement became effective. In order to satisfy the Commission on this point, Federal solicited and obtained from Chenery Corporation and the individuals affected by the Commission's opinion of March 24, 1941, individual agreements in the following form:

"KNOW ALL MEN BY THESE PRESENTS that

WHEREAS Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation have filed a proposed merger agreement between said corporations with the Securities and Exchange Commission in proceedings pending before the Commission under the Public Utility Holding Company Act of 1935, and

WHEREAS Federal Water Service Corporation has requested the undersigned to execute this agreement in order to assist Federal Water Service Corporation in securing the approval of the Securities and Exchange Commission to said merger agreement and any amendments that may be made thereto (said merger agreement and all amendments thereto being hereinafter referred to as the proposed merger agreement);

NOW, THEREFORE, in consideration of the premises and in consideration of the reliance of Federal Water Service Corporation upon the obligations contained in this instrument,

THIS INSTRUMENT, WITNESSETH,

1. That I am firmly obligated to Federal Water Service Corporation to hold the shares of preferred stock of Federal Water Service Corporation now owned by me and which were purchased by me after November 8, 1937 and not to sell or otherwise dispose of the same until November 1, 1941 unless prior to that date the proposed merger agreement becomes effective or is abandoned.

2. That if said proposed merger agreement does not for any reason become effective as provided therein prior to November 1, 1941, this instrument is void and of no force or effect for any purpose whatever and without affecting the generality of the foregoing, specifically this agreement shall not at any time be construed as or deemed to be an admission by me that the stock which I own and which was purchased by me after November 8, 1937 is in any way different from or entitled to any different or other rights than the preferred stock of the same series owned by any other holder.

3. That this instrument shall not be construed as a waiver of any right I may have to review in the manner provided by law any decision of the Securities and Exchange Commission or to take such action as I may be advised to protect my rights as they may be established on such review.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this day of , 1941.

.....(L.S.)"

One officer of a subsidiary who was included in the Commission's opinion because he was a director of Utility Operators Company did not own any preferred stock of Federal at the time of the Commission's opinion of March 24, 1941. He had, however, purchased 30 shares of preferred stock after November 8, 1937, and sold them on February 11, 1941 at a profit of \$94.35. He gave his check to Federal for this amount accompanied by a letter agreement reading in part as follows:

" * * * If any order of the Securities and Exchange Commission approving the merger agreement should be reviewed by any person or party aggrieved by such decision or order and it should finally be determined in such proceeding that the order of the Securities and Exchange Commission was erroneous in so far as it directed or authorized a discrimination against the preferred stock

purchased after November 8, 1937 by Chenery Corporation or an officer or director of Federal Water Service Corporation or Utility Operators Company, Federal Water and Gas Corporation will refund to me the sum paid to it hereunder together with 4% interest on the amount paid from the date of payment to the date of refund."

Also it appeared that certain individuals had sold stock upon which they had received a profit but retained sufficient preferred stock of Federal to enable the Commission to capture for the benefit of the corporation the amount of profit by reducing the price to be paid for the stock held on the effective date of the merger and the discriminatory paragraph of the proposed merger agreement was amended so as to provide:

" * * * In the event any shares of preferred stock of Federal Water Service Corporation purchased by Chenery Corporation or by the said officers or directors of Federal Water Service Corporation or Utility Operators Company since November 8, 1937, shall have been sold by such corporation or individual prior to the effective date of the merger agreement, the surviving corporation shall, upon the surrender of the remaining such shares owned by such corporation or individual, be obligated to pay to such corporation or individual a sum equal to the actual cost of all preferred stock of Federal Water Service Corporation purchased by it or him since November 8, 1937, together with interest thereon at four per cent per annum from the dates of its or his purchase of such stock to the effective date of the merger agreement minus the proceeds of the sale by it or him of any such shares together with interest thereon at four per cent per annum from the dates of its or his sale of such stock to the effective date of the merger agreement."

The merger agreement, as so amended, was approved by the Commission over the objection and protest of the corporation and individuals affected by the discriminatory

paragraph by order of the Commission of September 24, 1941. The merger agreement was executed by a majority of the directors of the constituent companies as of September 26, 1941 and submitted to the stockholders together with a report of the Securities and Exchange Commission. The report of the Commission (10 S.E.C. 194) stated (p. 198):

"Under the plan about 11,600 shares of preferred stock purchased by officers and directors of Federal and Utility Operators Company during the pendency of reorganization are treated differently from the other shares of preferred stock. The Commission felt that because of the circumstances under which the shares were purchased, these holders could not equitably be permitted to realize any benefit by their acquisition. The plan accordingly provides that these shares will be purchased for cancellation by the reorganized corporation at cost, which amounts to about \$285,000, plus 4% interest from the dates of acquisition by the present holders to the date of the merger. The company's letter states that an appeal is anticipated as to this feature of the plan and that it is believed that if the Commission's decision is reversed, the preferred stock held by the management should be permitted to participate in the reorganization on the same basis as the other preferred stock."

The stockholders were also notified by the Commission in its report and by the President's letter that under the Law of Delaware stockholders who made written objection to the plan were entitled to demand that their stock be purchased by the surviving corporation under Section 61 of the Delaware Corporation Law. But they were further advised that by the merger agreement, Federal Water Service Corporation reserved the right to abandon the plan if stockholders holding 3,000 or more shares of Federal's preferred stock duly objected to the merger at or prior to stockholders meetings at which the merger agree-

ment was submitted to a vote. At the stockholders meeting of Federal Water Service Corporation called to consider and act upon the merger, 13,504 shares of preferred stock were voted against the merger, but of this number 11,563 shares were voted by Chenery Corporation and the individuals discriminated against by the merger agreement. In order to assure the directors of the surviving corporation that demand would not be made against the surviving corporation for cash payment of the value of these shares, the proxies for such 11,563 shares of preferred stock were accompanied by letters, each of which was substantially as follows:

Federal Water Service Corporation
90 Broad Street
New York, N. Y.

Dear Sirs:

I enclose herewith proxy for the shares of preferred stock of Federal Water Service Corporation owned by me which are treated by paragraph FOURTH(d) of the merger agreement to be submitted to the stockholders at the meeting of October 28, 1941 differently from shares of preferred stock of the same class owned by others. I have checked the space on the proxy marked 'against'. Pursuant to the notice printed thereon, you are to regard this proxy as an objection in writing to the merger for purposes of Section 61 of the Corporation Law of the State of Delaware. I am taking this action in connection with the petition which I, as one of the interveners, have filed in the United States Court of Appeals for the District of Columbia to review the order of the Securities and Exchange Commission of September 24, 1941, and I hereby state with the intention that this statement should be relied upon by the Board of Directors of Federal Water Service Corporation in deciding whether to declare the merger agreement operative that

(1) if, in the proceeding taken by the interveners to review the order of the Securities and Exchange Commission, it is finally determined that said order shall be affirmed, I will surrender my stock referred to in paragraph FOURTH(d) of the merger agreement to the surviving corporation for cancellation for the consideration set forth in paragraph FOURTH(d) of the merger agreement;

(2) if, on the other hand, it should be finally determined in said proceeding that the said order of the Securities and Exchange Commission should be modified or set aside, I will accept stock of the surviving corporation in exchange for my stock referred to in this proxy as though the discriminatory and unlawful paragraph FOURTH(d) were not contained in the merger agreement and/or in satisfaction of any rights which I may have to the value of said stock upon the same terms as stock of the surviving corporation has been offered for exchange to others, not included in paragraph FOURTH(d) of the merger agreement.

Very truly yours,

The Board of Directors of Federal Water Service Corporation upon receipt of these letters declared the merger agreement operative and appropriate certificates were filed in the proper offices in Delaware on, October 31, 1941. Within the time allowed by Section 61 of the Delaware Corporation Law, Chenery Corporation and each of the persons discriminated against by the merger agreement made demands upon petitioner by letters in substantially the following form:

"Federal Water and Gas Corporation
90 Broad Street
New York, N. Y.

Dear Sirs:

This is to notify you that I contend that paragraph FOURTH (d) of the agreement of merger between Federal Water Service Corporation, Utility Operators Company

and Federal Water and Gas Corporation is illegal and in violation of my rights as the holder of shares of preferred stock of Federal Water Service Corporation which shares have been discriminated against by paragraph FOURTH (d) of the agreement of merger and I demand that you issue to me shares of your common stock of the par value of \$5 each in exchange for said shares of preferred stock upon the same terms and conditions as such common stock was offered to other holders of the same class by paragraph FOURTH (e) of the agreement of merger or in the alternative, I demand damages for the unlawful conversion of said stock by said paragraph FOURTH (d) of the agreement of merger, or in the alternative, I hereby demand payment for said stock pursuant to Section 61 of the General Corporation Law of the State of Delaware, all to the end that in the event the order of the Securities and Exchange Commission in so far as it approved said paragraph Fourth (d) of the said agreement of merger shall be modified or set aside, I shall have all the rights in the premises to which I am legally entitled.

Very truly yours,"

The foregoing facts show the posture of the case as it came before the Commission on petitioner's application and declaration for leave to amend the merger agreement. Petitioner's application and declaration set forth upon information and belief that there is no ground on which petitioner can require the persons and corporation referred to in paragraph FOURTH (d) of the merger agreement to surrender their stock in Federal Water Service Corporation and receive the consideration therefor specified in paragraph FOURTH (d) of the merger agreement.

This Court has jurisdiction to review said order of February 7, 1945 under Section 24 of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. A. § 79.

3. *The Relief Prayed.*

Petitioner prays that this Court review the order of the Commission of February 7, 1945 and that the said order be set aside in so far as it denied the application and declaration of petitioner.

4. *The Points upon which Petitioner intends to Rely.*

(a) The Commissioner misconstrued the opinion of the Supreme Court and failed to give effect to its mandate.

(b) The Commission erred in denying petitioner's application and declaration for amendment of the merger agreement.

(c) The Commission had no power to deny petitioner's application and declaration on the ground set forth in the Commission's findings and opinion.

(d) There were no facts before the Commission to support its conclusions that petitioner's plan for amendment of the merger agreement was detrimental to the public interest or the interest of investors or consumers, would result in an unfair and inequitable distribution of voting power or was not fair or equitable within the meaning of Sections 7 (e) or 11 (e) of the Public Utility Holding Company Act of 1935.

Dated, March 20, 1945.

Respectfully submitted

FEDERAL WATER AND GAS CORPORATION,

By ALLEN S. HUBBARD,

Attorney.

ALLEN S. HUBBARD

HUGHES, HUBBARD & EWING

One Wall Street

New York 5, N. Y.

Attorneys for Petitioner

EXCERPTS FROM ORIGINAL PROCEEDINGS BEFORE SECURITIES AND EXCHANGE COMMISSION.

Excerpt from Application for a Report on a Plan of Reorganization and Declaration as to Solicitation of Consents, filed Nov. 8, 1937.

14 The following table shows the names and positions of the ten largest holders of record of stock of Utility Operators Company as of November 4, 1937 and the numbers of shares and percentages of total stock held by each.

Name	Position	No. of Shares	Percentage
Chenery Corporation	(C. T. Chenery, Pres. of Applicant is also Pres. of Chenery Corporation)	5,378.1	9.53
C. T. Chenery	Pres. of Applicant	3,521.3	6.24
Earl C. Elliott & Meeda B. Elliott as joint tenants, etc.	(Earl C. Elliott is Pres. of California Water Service Company)	1,004.3	1.78
Russell H. Neilson	V. Pres. of New York Water Service Corporation & Scranton-Spring Brook Water Service Company	925.4	1.64
G. van den Berg, Jr.	V. Pres. of Applicant	909.4	1.61
Erastus C. Deal	Pres. of Scranton-Spring Brook Water Service Company	862.5	1.53
A. W. Cuddeback	Pres. of New York Water Service Corporation	792.5	1.40
Thos. H. Wiggin	Engineering Consultant to subsidiaries of Applicant	570.7	1.01
Wm. R. Edwards	V. Pres. of Rochester & Lake Ontario Water Service Corporation	570.1	1.01
C. P. Rather	Pres. Southern Natural Gas Company	525	.93
			26.68

17 The following table shows the names and addresses of the officers and directors of Applicant and their important legal, and engineering advisers (no person having acted in the capacity of a financial adviser in connection with the preparation of the Plan), and their positions and relationships to Applicant and its affiliated companies:

Name	Address	Positions and Relationships
Officers		
C. T. Chenery	90 Broad Street, New York, N. Y.	President & Director of Applicant President & Director of Utility Operators Company

Name	Address	Positions and Relationships
C. van den Berg, Jr.	90 Broad Street, New York, N. Y.	Officer & Director of important subsidiaries of Applicant Vice-President & Director of Applicant Officer & Director of Utility Operators Company Officer and/or Director of certain subsidiaries of Applicant
Walter A. Culin	90 Broad Street, New York, N. Y.	Vice-President & Treasurer of Applicant Director of Utility Operators Company Officer and/or Director of certain subsidiaries of Applicant
H. M. Erskine	90 Broad Street, New York, N. Y.	Vice-President of Applicant Director of certain subsidiaries of Applicant
18 J. N. Greene	90 Broad Street, New York, N. Y.	Vice President of Applicant Officer and Director of Utility Operators Company Officer and/or Director of certain subsidiaries of Applicant
H. D. McHenry	90 Broad Street, New York, N. Y.	Vice-President of Applicant Officer and/or Director of certain Subsidiaries of Applicant
Frederic T. Tansill	90 Broad Street, New York, N. Y.	Vice President and Secretary of Applicant Officer and Director of Utility Operators Company Officer and/or Director of certain Subsidiaries of Applicant
Directors other than Officers		
A. W. Cuddeback	90 Broad Street, New York, N. Y.	Director of Applicant Director and Officer of Utility Operators Company President and Director of New York Water Service Corporation and Officer and/or Director of certain other subsidiaries of Applicant

Name	Address	Positions and Relationships
W. Findlay Downs*	Packard Bldg. Philadelphia, Pa.	Director of Applicant Director of Scranton- Spring Brook Water Service Company, subsidiary of Applicant
19		
Directors other than Officers (Continued)		
Frederic R. Harris	27 William St., New York, N. Y.	Director of Applicant Director of New York Water Service Corporation and Scranton-Spring Brook Water Service Company, subsidiaries of Applicant
Harry O. King	59 East 75th St., New York, N. Y.	Director of Applicant
Edward W. Robinson	331 Madison Ave., New York, N. Y.	Director of Applicant

EXCERPTS FROM TESTIMONY.

Testimony of Christopher T. Chenery, July 22 and 23, 1940.

2755 Q. Mr. Chenery, before the plan now before the Commission, which was filed on March 30, 1940, was filed were you advised by Mr. Culin that he had been advised by Mr. Kennedy that the Commission had approved the filing of that plan?

Mr. Baldy: Let's put Mr. Culin on; Mr. Hubbard.

Mr. Hubbard: I withdraw the question.

Q. Now, Mr. Chenery, during the pendency of these plans before the Commission did the Chenery Corporation purchase preferred stock of the Federal Water Service Corporation? A. Yes.

Q. I show you a schedule purporting to show the purchases of preferred stock of Federal Water Service Corporation by officers and directors of Federal and Utility

Operators Company from November 8, 1937, to June 30, 1940, and ask you if that was prepared at your request or suggestion. A. It was.

Q: And it is accurate according to the records of the company and in accordance with your best knowledge and belief? A. It is.

Mr. Hubbard: I offer it in evidence.

The Examiner: Admitted.

(The schedule referred to was received in evidence as Applicant's Exhibit No. 33.)

Q. Now, Mr. Chenery, I ask you to turn to page 3 of this Exhibit No. 33, and I ask you to describe the Chenery Corporation. A. The Chenery Corporation is a family investment corporation formed in 1926. Stockholders are my three brothers, my sister, my wife, my three children, and myself.

Q. What percentage of the stock of Chenery Corporation do you own? A. I own approximately 10,000 shares of approximately 23,000 shares.

Q. Now, Mr. Chenery, why did you purchase this preferred stock? A. I purchased it—(interrupted)

2757 Q. (Interposing) Why did the Chenery Corporation purchase the preferred stock? A. Chenery Corporation purchased it on my advice. I have felt, have testified, and have told everyone who has asked me over the past years that I thought that preferred stock of Federal Water Service Corporation, over a long period of time, was sufficiently sound so that it would again pay dividends and that this would be true whether any plan of reclassification was consummated or not, that there were inherent values in the Corporation which would be reflected in the stock and that if no plan of reclassification were put through, that the accumulation of the earnings over a period of time would be sufficient to cure the deficit and dividends would again be resumed.

Also, the officers and employees of this Corporation bought the B Stock in 1932 at my suggestion and on my advice and paid approximately \$600,000 for it, contracted to pay more. The situation of the Corporation since that time has improved substantially. This B Stock was bought by all classes of employees. I think more than 99 percent of officers and employees bought it and paid for it by deductions from their salaries over a three or four-year period.

The original plans for reclassification contemplated that the B stockholders would be given an opportunity to buy their way back in the Corporation, first by giving
2758 them a special stock which was convertible into new common stock upon the payment of cash and which maintained their voting power over a period of years; second, by giving them options so that it was all the time contemplated that these people who held this Corporation together by contributions from their salaries and wages should not be thrown out. I have always regarded the ownership of this stock by the employees of the Corporation as one of the great assets of the Corporation.

Then the view shifted and apparently the feeling was that little consideration should be given to the B Stock and finally that none should be given to it. The voting control of the B Stock was thrown into the open market for anybody to pick up who desired it. I had knowledge first that the preferred stock was freely traded on the market, that there were any number of investment bankers buying and selling it constantly and secondly, that strong financial interests were accumulating substantial blocks of this stock.

As long as we thought that a plan would be worked out which would give the B Stock an opportunity to come back in the future, my suggestion was to those stockholders and I think I testified to this effect at the first hearing here in 1937 that they should save so that at the expiration or at the end of the period, they would be in a position to exercise the option and acquire that stock. Then when it be-

came apparent that this was not to be, a meeting was
 2759 held of the B stockholders and it was their decision
 that they would contest any plan which worked them
 out completely and the suggestion was made that it would
 be wise to purchase such preferred stock as they reasonably
 could so that in the event that there was litigation and the
 plan was not worked out and that finally it should be held
 that the B stock was not entitled to anything, that these men
 who had held this Corporation together and who were its
 loyal servants would still have some position in the Corporation,
 some voice.

It was that consideration, as well as the feeling that the
 stock itself was inherently worth what was being paid for
 it, which prompted me to advise Chenery Corporation as
 well as to advise others who asked me I thought it was wise
 for them to buy the preferred stock.

Q. The preferred stock is bought and sold on what is
 known as the open market, is that true? A. That is true.

Q. Do you know whether quotations are published daily
 in newspapers? A. They are so published.

Q. What are the newspapers in which the quotations are
 published? A. The Tribune and, I am not sure, the Wall
 Street Journal. I know the Tribune.

Q. Were your purchases made on the market? A.
 2760 They were made through dealers in the stock purchased
 on the open market, with one single exception,
 and that was a transaction under which Chenery Corporation
 exchanged with an investment banking firm of Ingalls
 & Snyder 100,000 principal amount of Federal Water Service
 debentures for 2,700 shares of 6½ equivalent preferred
 stock.

Q. That is the transaction referred to on Exhibit 33 in
 the last three items, is it not? A. That is so. Ingalls &
 Snyder acted in part as a broker and part as principal there
 in that they sold part of their own stock or stock of their
 clients. They were one of the firms which I referred to
 who had accumulated the stock and I was told that they

had purchased for the account of themselves and their clients with the idea that it might be potential control of approximately 12,000 shares of the stock.

Q. At any time, did you discuss with any person in the S. E. C. staff the question of the Corporation's possibly buying preferred stock? A. Yes.

Q. Do you recall when that was? A. I have a memorandum on the subject.

Q. Will you refresh your recollection by looking at 2761 the memorandum? A. It was a meeting on April 26, 1939.

Q. What was the situation at that time and how did you happen to discuss it? A. We had first a meeting in Judge Healy's office; present—Judge Healy, Mr. Spencer, Mr. Levy and Mr. Kennedy, Mr. Hubbard, Mr. McHenry and Mr. Chenery.

At that time, plans were apparently stalemated. This meeting later adjourned to Mr. Spencer's office. I had never discussed any plan for the purchase of preferred stock as a method of working out a reclassification plan until this time because the plans, up until that time, had contemplated an all-common stock plan. If we had an all-common stock plan, there is no reason to sell your assets, to buy and retire preferred stock. Apparently we were stalemated on the plans which we thought were practicable at this time and I made the suggestion that we might be able to work out a reclassification plan by the purchasing and retiring of preferred stock which would involve the buying of large blocks of preferred stock. I think I had 60,000 shares in mind at that time and later suggested 30,000 shares.

I asked Mr. Spencer what he would think of such a plan and Mr. Spencer said he thought it was terrible. The Corporation prior to that time had had excellent use for its funds. Such spare funds as it had, such spare earnings as

it had, it was using to buy its own indebtedness at 2762 the fraction—not as a fraction, somewhere in the 70's. It was buying preferred stock of Scranton-

Springbrook in the 20's and had full and adequate use for its earnings.

I might correct that statement by saying we had discussed in the early days, 1937, a possible plan which would have involved as a part, a purchase of preferred stock owned by Utility Operators Company but that was not presented as a straight raising of the issue. The first time that I have either a memorandum or a clear recollection of the issue being raised was at this conference with Mr. Spencer and I think Mr. Spencer at that time added that the use of corporate funds to retire preferred stock at a fraction of its value and thereby to sweeten the position of the securities, the stocks junior to it, was entirely contrary to his thinking.

Q. Now, Mr. Chenery, during the period that the company has been a registered holding company, you had filed from time to time, in accordance with the Act, the reports of purchases and sales of any securities of the Federal Water Service Corporation? A. Made either by myself or by Chenery Corporation.

Mr. Hubbard: I call upon the Commission to produce the reports of the purchases filed by the Chenery Corporation.

(The reports were handed to Mr. Hubbard.)

Mr. Hubbard: Off the record.

(Discussion off the record.)

2763 Mr. Hubbard: I now offer in evidence the reports that have been filed with the Securities and Exchange Commission on Form U17-2 by Chenery Corporation and the individuals named upon Exhibit 33. I suggest that it be stipulated that it is unnecessary to have these forms physically marked in evidence but that, being a part of the Commission's files, they be considered part of the record in this case.

The Examiner: Off the record.

(Discussion off the record.)

Mr. Hubbard: If your Honor please, I am going to offer in evidence the Form U-97 reports as received by the Securities and Exchange Commission covering purchases made by officers and directors of the Federal Water Service Corporation and we will work out a stipulation between Mr. Baldy and myself so that it will be unnecessary to have these records physically incorporated into the record of this hearing.

The Examiner: If it is to be stipulated, there is no need of having an exhibit number now.

Mr. Baldy: All right, your Honor.

By Mr. Hubbard:

Q. Now, Mr. Chenery, in the tentative findings and conclusions of the Commission, the statement is made:

"It should be borne in mind that, here, as is frequently the case, the discretion and judgment of the management is as a practical matter, largely determined what kind
2764 of a plan of voluntary reorganization shall be proposed but when it shall be proposed."

What have you to say with respect to that statement?

A. I would say it just is not so.

Q. And as an illustration of the correctness of your statement, you cite this case? A. I cite this case. The management cannot suggest a plan at any time to stockholders—it can only file one with this Commission—unless and until this Commission permits it to be presented to the stockholders with its consent. So far as the plan, we have had plans held without action for two years at a time.

2799 Q. Now on November 8, 1937, you filed the second plan, did you not, Mr. Chenery? A. The special stock plan?

Q. No, no, I am leaving the special stock plan. Now that is the first one you formally filed. Coming now to the second you formally filed— A. The first one is November 8, 1937. The second one was in May.

Q. Then on May 19, 1938, you filed an amendment which provided a plan as an alternative to the special stock plan, did you not? A. That is true.

Q. That plan called for a mere reduction of the capital represented by the outstanding shares of the several classes, did it not? A. Several classes of stock, yes, sir.

Q. What you were going to do was just reduce the capital represented by the several shares or otherwise leave them alone? A. Without any change of rights or preferences of the stock, all of its—each stock retaining all of its characteristics with the single modification of stated value applicable thereto.

Q. That would have cured the impediment to the 2800 payment of dividends? A. That would.

Q. And otherwise wouldn't have changed the shares? A. Changed any rates or preferences—would not have.

2806 Q. Now the thing that is not clear to me, Mr. Chenery, is that when you later came along with the next plan, which is the one presently before the Commission, you departed from the terms and provisions of the plan we were last discussing. The present plan is an all common stock plan and the one which you had pending when the Havender case difficulty came along called for different terms and provisions.

In order that the record may show what led from one plan to another, would you explain how the present plan evolved? A. It is summarized in Answer 6, to Question 6, in the application, which I should like to read as being my answer:

(Reading) "The file with the Commission (File No. 34-9) shows that Applicant has desired for some time to

2807 reduce its capital in order that it might pay dividends. The file also shows that Applicant has for some time desired to reorganize in a manner permitted by the Delaware Corporation Law. The recent decision of the Supreme Court of Delaware in *Havender v. Federal United Corporation* shows that this can be done by merger proceedings under Section 59 of the Delaware Corporation Law. Promptly after this decision was rendered by the Supreme Court of Delaware, Applicant's officers took up with the staff of the Securities and Exchange Commission a plan of reorganization through merger with Utility Operators Company and Federal Water and Gas Corporation, and this plan is the result."

Q. Well, I wasn't addressing my question to the mechanics of carrying out the plan. I just wanted to bring out why it was that the substantive provisions of the plan were changed; in other words, why the switch over to an all common stock plan. The plan that was pending, that was blocked by the *Havender* case, so far as being carried out in the way your counsel would like to have it carried out, as you said, wasn't in its substance the same as the present plan? A. No.

Q. And I want to bring out the reasons for the change. A. Well, it had always been the desire of the management to have an all common stock plan, and before this was a registered holding company the corporation had proposed to stockholders in October, 1936, an all common stock plan. In the meantime these legal difficulties had arisen. When they were cleared by this Supreme Court decision referred to, and the way apparently was open to an all common stock plan again, that was the plan which the management considered preferable, and which it suggested, and which we thought also was in harmony with the desires often expressed by the staff of the Commission.

2809 Christopher T. Chenery, the witness on the stand at the hour of recess, resumed the stand for further examination, as follows:

Cross Examination (Continued)

By Mr. Baldy:

Q. Mr. Chenery, I think we have covered, after a fashion, the history of the discussions that you had with the staff regarding these various plans. All of the plans which you have filed contained some recognition for the B stock, did they not? A. Yes.

Q. In the plan presently before the Commission, the recognition takes the form of a staggered board of directors, is that true? A. Yes; it is quite attenuated consideration.

Q. Yes. That is the only consideration in the present plan? A. That is the only consideration.

Q. All of the others contained considerations somewhat more substantial, than that? A. Yes—substantially more.

Q. And is this decrease or this diminishing consideration for the Class B stock, as evidenced by the succession of plans filed, due to views expressed by the staff? A. Yes.

Q. And is it true to say that the question of what treatment should be accorded the Class B stock under the applicable standards of law has been one of the major topics of consideration between you and others connected with Federal and the staff? A. One of the major topics, yes.

Q. Would you say it would be in your judgment the chief topic? A. Well, I think the consideration to the A and the B were the chief topics.

I will add to that, if I may, that in a voluntary plan you had to have a plan which the stockholders would vote for, and until—so a great deal of consideration was given to what treatment, what was the minimum treatment that the stockholders would approve, the A and B stockholders.

Q. Well, do you think if you and the staff had been able to see eye to eye on the treatment that should be accorded

the B stock under the applicable standards of law that the length of time that has elapsed during which you have been trying to get plans through here would be materially less?

A. Well, Mr. Baldy, since the last action of the Commission I am not sure that would have had any effect at all. 2811 I think it is entirely unpredictable.

Q. What do you mean, "the last action of the Commission"? A. Well, in the tentative findings which they have handed down.

Q. Well now, if one of the chief points of difference between yourself and the staff has been the treatment that should be accorded these two classes of stock, hadn't been a point of difference isn't it reasonable to suppose that the length of time that has elapsed would not be so great? A. Well, I don't know whether they would have found something else if that hadn't been the point, because in these tentative findings they bring up the question of the purchase of the stock as being something else which they would have to consider, and when that has been before them for years and when the ownership of this stock by us had been used by Mr. Weiner as one reason why we didn't need a staggered board, then to bring it up at this time, it seems to me we just couldn't predict what would happen under any circumstances until a final order came down in writing.

Mr. Baldy: Will you read the last answer?

(The answer was read by the reporter.)

Q. Well now, how could the stock holdings be before the Commission for years, Mr. Chenery, when a great deal of your stock has been fairly recently acquired? A. 2812 Well, this stock has been purchased over a substantial period of years. In the first hearing it was commented on, there was testimony about it. Reports have been filed monthly with the Commission showing each and every purchase. The staff has had full knowledge of it, and has used it in the arguments with us as to why we didn't need a staggered board.

Q. You mean that Mr. Weiner indicated that he thought the staggered board was not very important from your standpoint in view of your holdings of preferred stock? A. Holdings of preferred stock of the group, yes.

Q. Yes. Did any member of the staff ever express any views to you about the propriety of your accumulating stock during the pendency of the plans of reorganization?

A. I have no record of any member of the staff making any such comment to me.

Q. It is just a thing that didn't come up for discussion at all, isn't that right? A. Just a thing that didn't come up for discussion at all. It was full knowledge of all concerned.

Q. Is it true to say that your motive in purchasing the stock that you have purchased while plans were pending before this Commission was the combined motive of increasing voting power plus the expectation that it would prove a financially desirable investment? A. Yes, I think 2813 that is true. I think there is more stress on the voting power than on the investment, however.

Q. You mean from the standpoint of what motivated you? A. Yes.

Q. That was your primary motive? A. Yes, that was true.

Q. The other motive, however, was present to some extent? A. The other motive was present to some extent, yes.

Q. Now did you at any time request or recommend to any other officers or directors of Federal or the subsidiaries that they accumulate preferred stock? A. Yes.

Q. Will you describe, please, the nature of those recommendations? A. I think it was after we had been advised by the staff in 1938 that the Commission would not approve the plan, the plan then before it, the special stock plan, I thought that we were headed in for litigation with the Commission on the capital reduction plan. I contemplated the possibility that we might lose. I thought we would win, but I thought we might lose, and these officers and employees

had bought this B stock on my urging and they had paid for it with deductions from their salary over a three or four-year period, and I did not want to see a situation in which the control of this company would be thrown 2814 in the open market and anybody with a few hundred thousand dollars can step in and pick it up. I wanted the employees if they lost the B stock to have some secondary line of defense, which I thought would be in the ownership of the preferred stock, and I said it was my view that it was sound policy for every person in the employ of the company who could spare the money to buy such preferred stock as they could carry, and that I would buy all that I could, through the Chenery Corporation.

Many of them did buy such preferred stock. In some cases groups got together and borrowed money from the bank to be paid over a period of time with which to buy this preferred stock.

In the case of Chenery Corporation, we liquidated dividend-paying securities at a loss in order to buy this stock.

The pendency of the plan, the time of the plan, had nothing to do with it. When we could sell this stock and buy up Federal preferred on pre-determined ratios, the orders to the brokers were to sell the other stock and buy Federal preferred.

Now I take full responsibility for the purchase of stock by officers and employees. I not only thought it was a sound thing for them to do, I thought it was highly desirable, not only from their viewpoint but from the viewpoint of 2815 the corporation, and I so expressed that opinion. I also said that I thought that the stock was inherently sound; that over a period of time, whether we had a plan or did not have a plan, that they wouldn't have any loss in the stock.

Q. It was your expectation they would have a good profit?

A. It was my hope they would have a good profit.

Q. Wasn't it your expectation? A. At some time in the future. Whether that time was one or X years I didn't

know, but I thought if this present economic system rocked along on the present basis that some time in the future that stock would be good.

Q. Particularly if and when you succeeded in getting the capital deficit cured? A. It couldn't pay dividends until the capital deficit was cured, but it didn't require a plan to cure the capital deficit. The processes of time will do that itself.

Q. But it was your expectation that in all probability the preferred stock would have a substantial rise in market price if and when the capital deficit was cured? A. And it again paid dividends, yes; but I hadn't the foggiest idea when that would be, whether it was six months or six years, and so stated.

Q. That was because you didn't know how long it was going to take you to get through down here, was that 2816 it? A. Whether we would ever get through down here or not.

Q. Well, to what do you ascribe the fact that it's taking so long to get through down here? A. Well, I ascribe it to the changing viewpoints of the Commission. I think it is a perfectly reasonable explanation that this Commission has been, in the last year, in a constant state of flux. There have been people coming in, people going out. Each new group have had their own views of the law and what was permitted and what was prohibited. The law itself, as interpreted by the legal division of the Commission, I think has changed during the period of this thing. I think that for the first time since we got a community plan through you make a flat statement that voting power can't be recognized. I don't think they thought that was the law before; if so, the memorandums which we had are inexplicable.

I think the thing has been—it is your Commission and its conception of its law, of the law in which it operates, and its duties under that law, which have been in a state of flux and are now beginning to crystallize, and that we

happened to come along with one of your first cases, one of your most involved cases, which presented a great many problems which would be applicable to other situations, and they considered our case—not only considered how it affected us but how it might affect other companies 2817 which were either before you or which might come before you, and you are making new grounds on the trial, took your time to look at it. By the time you had come to a conclusion there would be something new developed and you would stand off and look at it again.

Now I am not critical of that. I think it's been hard on the Federal preferred stockholders. I think but for the action of this Commission that they would have had more than a million dollars disbursed to them in the last two or three years, which they were reasonably entitled to and which we could have paid, and I doubt very much that any minor changes which you make in this plan will recompense these preferred stockholders for the million dollars they didn't get—and the million dollars is an under-estimate, rather than an over-estimate.

Q. But you have at no time deemed the situation of the preferred stockholders such as to warrant you in abandoning the idea that you should get something for the Class B stock? A. No. I see no—

Q. (Interposing) That is all right. That is the answer. A. I would like to amplify it, if I may, if you really want to know what I think.

Q. I think you have answered the question. A. All right.

Testimony of Walter A. Culin, July 23, 1940.

2848 Q. Now, Mr. Culin, according to your Exhibit No. 33, you apparently are one of the purchasers of preferred stock of Federal Water Service Corporation. Will you state the circumstances under which you purchased that preferred stock and why you made the purchase?

A. I recall that during the summer of 1938 after we had

had discussions with the staff of the Commission about re-organization plans, and in particular the reduction of the capital plans, we had discussions in our office as to the advisability of the individuals, officers and some of the employees buying preferred stock of the company.

I was in agreement with that thought both from the standpoint of wanting to strengthen our position as the management group in our voice in the company and also I believed that ultimately the stock would be of value in excess of what I would probably have to pay for it at that time.

I bought 50 shares in September 1938, ten shares in November 1938, making a bank loan to buy some of it and later on when I paid that loan I made another loan and bought some more in 1939 and January 1940.

Q. Do you have any information with respect to the pendency of the plans which you considered not available to other stockholders at that time? A. I certainly did not. I always advocated the policy that if at any time we had discussions pending before the Commission it was not the time for us to buy any stock because we might later be criticized and we were always careful when we were in the midst of what we considered to be important conversations with the Commission or the staff of the Commission, that it was not the time for us to buy the stock, that we might be criticized later. We have always been very free in giving information to everybody who asked us for it.

Q. And at various times requests were made for information from you with respect to the status of a plan? A. I have had many requests from stockholders, security dealers, and newspaper for information of the plan, and excepting at certain periods when we were right in the very midst of the discussions, we have always given out all the information that was available, everything we knew about it.

Q. You have never purchased any stock at any time where information wasn't entirely available to everybody?

A. I have not.

Q. What sources of information did people have with respect to securities of the Federal Water Service Corporation and their value? A. The statistical agencies carried pretty full information about the plans. Since 1937 we have had on file a great amount of detail in the S.E.C. We have always given information to various brokers and in-
2850 vestment dealers and they have published and distributed a number of memoranda about the plan and about the company, and at various times the newspapers have asked us for a release or have asked us to give them a story as to the company and its position, its finances and the status of the plan.

Q. And from time to time the Commission issued releases, did it not, with respect to plans? A. When we filed plans with the Commission, they then published a release.

Mr. Hubbard: Off the record.

(Discussion off the record.)

By Mr. Hubbard:

Q. Mr. Culin, do you have something to do with the preparation of annual reports to stockholders? A. I do.

Q. And you endeavor to give stockholders all the information about the company? A. Yes.

Q. And quarterly earning statements are published in the financial pages of the newspapers, are they not? A. That is right.

Q. Newspapers carry reports of various plans from time to time, plans that are before the Securities and Exchange Commission, do they not? A. They do.

2851 Q. I think you testified that Standard Statistics give periodic reports with respect to the position of stocks? A. Yes.

Q. And from time to time various investment houses also give information and advice with respect to stock? A. Yes.

Q. The stock of the Federal Water Service Corporation? A. Yes.

Mr. Hubbard: That is all, Mr. Culin.

Cross-examination

By Mr. Baldy:

Q. Mr. Culin, will you identify the conversations that were of such character that you did not feel it would be proper to purchase stock while they were in progress? Will you give dates? A. There were discussions in the latter part of December 1937, December 16 and December 22, 1937. I would like to withdraw that answer.

I was present in discussions on December 5, December 27, and December 29, 1938.

Q. December? A. December 5, 21, and 28, 1938, and a telephone conversation on December 29.

Q. Were those conversations of the kind referred to in your direct testimony as being of such kind that
2852 you didn't consider it proper to purchase preferred stock while they were going on? A. No, because at that time there wasn't anything definite coming out of the questions.

Q. Well, my question is addressed to conversations of the kind you referred to in your direct testimony. I am asking you to identify which they were. A. On March 29, 1939, I had a telephone call from Mr. Spencer telling me that there had been informal approval by the Commission of the new plan.

Q. What date was that? A. March 29, 1939.

Q. March—what? A. March 29.

Q. Pardon me. I don't want to interrupt your answer. Just continue your answer. A. It seemed at that time that we probably would have a new plan but shortly after that further discussions with the staff indicated that we were still far apart on the plan. I refer particularly to telephone conversations of April 13, 1939.

Q. What do you mean by the plan? You said you were still pretty far apart on the plan. A. That was the preliminary discussions which ultimately led up to the plan which was filed in May 1939, which was upset by that

2853 Havender decision. The other time that I was having discussions with members of the staff, during which period I thought it would be improper to buy preferred stock, was March 1940.

I received a telephone call on March 25, 1940, from Mr. Kennedy, explaining that the Commission thought we should go ahead and file the plan. That plan was then filed and became public information on March 30, 1940.

Q. Well now, how did you determine how long this disability to purchase that you felt you were under should continue? A. Until the information I had became public.

Q. I see. I have nothing more to ask Mr. Culin at this time.

Re-direct examination

By Mr. Hubbard:

Q. Mr. Culin, taking these conversations you just testified about to Mr. Baldy, will you state for the record what information you had at that time from the staff of the Commission? A. The information which I had from the staff of the Commission was that the matter had been discussed in the Commission and that they thought the plan was sufficiently meritorious to go ahead and file it. There was a short period in there when I knew something that wasn't public information. When the plan was filed it became public information.

Mr. Baldy: I think it would be worth while to be specific if you can, about dates, that on such and such a
2854 date you felt it would not be proper to purchase, et cetera.

The Witness: I did.

By Mr. Hubbard:

Q. And you have selected from these dates which you have a record of, the particular dates which you testified about in answer to Mr. Baldy's question? A. That is right.

Q. And this policy which you testified about is applicable to the purchases by other officers and directors of the system? A. I think it is pretty generally true of the other officers and directors of the system.

Mr. Baldy: Wait a minute—all right, I will let it stand. Do you, in fact, know whether that policy was followed by the other officers and directors?

The Witness: I know it was followed by the other officers and directors prior to 1937. There was some purchasing of preferred stock at that time, more with the idea of preventing the market from just going to pieces at that time than anything else, insofar as those few purchases could help.

By Mr. Hubbard:

Q. And those purchases were criticized, were they, by a stockholder? A. In December of 1937, yes. It was after that that we talked about it and felt that we should not make any purchases which might be criticized.

I think there were very few exceptions—I think that with very few exceptions that policy was adhered to.

Mr. Baldy: You think so?

The Witness: I have studied the record and there were very few purchases that were made at any time except when full information was in the hands of the public and any purchases which might have been made, so far as I can determine, were of very small quantities and would be for some reason which doesn't appear in the information which I have.

(Witness Culin excused.)

Mr. Baldy: Will you take the stand, Mr. Chenery?

Whereupon, **Christopher Chenery**, resumed the stand and testified further as follows:

Recross-Examination

By Mr. Baldy:

Q. Mr. Chenery, have you heard Mr. Culin's testimony?

A. Yes.

Q. You heard the portion of it relating to his feeling disqualified or feeling that it might be improper to make purchases of Federal stock at certain periods of time? A. Yes, sir.

Q. Did you have any policy corresponding to his in that regard? A. I had nothing to do with it at the time 2856 we were purchasing Chenery Corporation stock other than to agree in advance that a certain long-range policy would be pursued; in other words, that we would sell "X" shares of Alabama Water Service Corporation when we could buy three shares of Federal with the proceeds of the sale of one Alabama.

We gave general instruction to liquidate 700,000 or 800,000 shares of one and buy the other as those ratios of market prices came on the market. That was true, I think, with all of the substantial purchases of Chenery Corporation. The orders were given to brokers to buy when those ratios obtained.

I had no knowledge of when that was bought or sold after the decision was made to liquidate one security and buy this preferred.

Q. Now, with regard to the placing of instructions with the brokers, was there any period of time in which you felt that it would have been proper to give instructions to brokers or cancel instructions previously given? A. I think that you would not give instructions at any time unless you had special information, but my feeling has been that if there is one corporation that has ever operated in the full glare of publicity, that this one is it. It was one of the first corporations to start and give full and complete details of every transaction.

2857 Standard Statistics has given reports at three-months intervals. There have been a dozen brokerage houses which have circularized preferred stockholders consistently, telling them of every development and plan and advising them what to do.

Our own policy has been not to refuse any stockholder any information at any time. There is no record since we have been in control of the company since March 14, 1932, of our having refused any stockholder any information on any subject.

Q. Well, can you identify for the record in a manner similar to that Mr. Culin did, periods of time in which you think it would not have been proper for you to give instructions to brokers? A. I hadn't thought of it in that light because at the time it was not in connection with any plan but over a long-term period and the plan would have little to do with it.

Q. Have you any record of the instructions which you gave brokers? A. I could identify it only by the time at which they started to liquidate substantial blocks of stocks.

Q. The record as to purchases, as I understand it, is already in? A. That is true.

Q. I don't think that the record of your instructions to brokers is in. A. I don't think that we have written 2858 instructions to brokers. I think we would have told them to sell "X" shares of Alabama as you can buy three for one in Federal preferred.

Q. You think they would have been oral? A. Pardon?

Q. You think they would have been oral? A. I think they would have been oral. We may have had some written orders to sell but after the decision was made I did not follow it.

Q. Was there any publicity given to the instructions that you gave brokers? A. No.

Mr. Baldy: That is all.

Redirect Examination

By Mr. Hubbard:

Q. Do you recall what those instructions were? A. To brokers?

Q. Yes, with respect to the sale of securities and the purchase of securities, other than you have testified to. A. I don't remember any other circumstance.

Q. At any time did you feel that you had any confidential information which was not available? A. I have never felt that after the first debacle, let us say, when I have testified on the stand, I never considered a plan imminent and I don't now consider one imminent.

Mr. Baldy: I don't quite get this last testimony in 2859 conjunction with what you previously said. Am I to understand now that you have never felt that you had any special knowledge that would make it improper for you to buy and sell stock?

The Witness: I never felt that the plan was imminent.

The Examiner: And therefore did it have any effect on your purchases or sales? That is your question. The question is whether you had any such expectation of a plan going through as to affect your own buying and selling of the stock?

Mr. Hubbard: You have never sold any?

The Witness: I have never sold any preferred stock.

The Examiner: Well, all right, buying.

The Witness: I don't think in any discussions which we have had with brokers the question has come up.

The Examiner: Has it affected your buying?

The Witness: It hasn't affected my buying because so far as I know, I have never had anything to do with the timing of the buying. The buying would take place over a long period of time. The broker would liquidate a block over a period of months and buy over a period of months.

The Examiner: All right.

The Witness: I expect, though, if you would examine the record of our purchases, you would find that there were very few made at any controversial times.

Mr. Baldy: Has this practice of yours about leaving general instructions with brokers been a long continued practice on your part?

The Witness: Over a period of several years.

Testimony of Roscoe C. Ingalls, July 23, 1940.

2877 Q. Now, Mr. Ingalls, did you have anything to do with the sale to the Chenery Corporation of 2700 shares of preferred stock in June, 1940, for \$100,000 debentures? A. Yes, sir.

Q. Just describe what you did and the circumstances of that transaction so far as you know them. A. The idea of an exchange of those securities had been spoken 2878 over the telephone between Mr. Erskine and myself I imagine about a month previous, at which time we were not interested in making any exchange, but not only market price but events abroad led us to believe that it might be an advantageous thing for us to make an exchange, and particularly in view of the fact that another firm, Gilbert J. Postley & Company, were anxious to make a similar exchange if we would go along with them.

The first offer I believe had been for 2800 shares of stock of the Federal Water Service 5½'s; and about June 1 or 2, throwing the thing over again, we made a counter-offer to Mr. Erskine in which we offered 2500 shares of the various preferred, 6, 6½, and 7, in exchange for a hundred debentures, but the majority of it would have been 6½ and 7% preferred stock.

This was not of interest to them, and nothing further happened until the 10th day of June, at which time we talked again with Mr. Erskine, and, as you recollect, that is the day that Italy declared war against France and England, and Mr. Erskine told me, he said, "Well, I would

much prefer to have you talk directly to Mr. Chenery and not have me as the go-between on this. You two fellows might just as well talk the thing over, and probably could come to a basis of trade quicker than if it was done through myself as a third party."

So that afternoon about 3:30 I went over to Mr. 2879 Chenery's office and talked the whole thing over, as to how far the plan was before the SEC and as to what the effect would be if France capitulated, and all the various other factors that you can think of regarding that trade and the possible future market value.

We finally came to a basis of making it 2700 shares of an average of $6\frac{1}{2}\%$ preferred stock for a hundred of the bonds. Knowing full well—and after having answered many questions regarding the company and the prospects of the SEC's approval, which looked as though it might be handed down just almost any day, I felt in view of the serious state abroad I would much prefer to have the bonds at that time than the preferred, even though I might lose somewhat in market value if the plan was approved immediately by the SEC in the next two or three days, or if, for instance, France and England were able to make a victorious battle between Germany and Italy. And today I am very much delighted we made the trade. It was a toss-up as to which it was going to benefit the most. So far I believe—I know as far as we are concerned it's been a most satisfactory trade.

Q. Now do you recall a transaction in which Green, Ellis & Anderson were interested at one time? A. Yes. As I 2880 recollect, it was some time just after war had been declared in September—it may have been 30 or 45 days after that—that Mr. Erskine called me up and said that Mr. Nosworthy of Green, Ellis & Anderson had asked him if he could make a bid on a little block of Federal preferred that was held by one of their correspondents abroad, and we called up—

Mr. Hubbard: (Interposing) May I have the name stricken out? Mr. Erskine suggests the possibility that

people there in New York might not want to have their names used, so I suggested instead of—could we substitute “a brokerage firm” for “Green, Ellis & Anderson”?

Mr. Baldy: No, I think we ought to have the names. If it is going to be talked about at all, we ought to know who it is they are talking about.

Mr. Hubbard: All right.

A. (Continuing) We—or I called up Mr. Nosworthy and told him that Mr. Erskine had mentioned that they were interested in a bid for a block of the stock and that we would be very glad to make a bid for it. Subsequently, I think it turned out to be, instead of 700 shares turned out to be nearly 1500 shares of stock that we purchased from them and then we distributed.

Q. Did they tell you where the stock was owned? A. Just it was held abroad.

Q. And you made the transaction under those circumstances? A. That is right.

2881 Q. Now, Mr. Ingalls, one of the questions that has been raised in this case is with respect to purchases by officers and directors of the company of the company stock. Have you any views with respect to that question? A. Well, I am a great believer in officers and directors owning stock in their own companies. I, frankly, always am impressed in my own mind when I see a company, whose officers hold very little, if any, of the stock of their companies; and those who have enough confidence in their company to purchase their securities and hold them and retain them I believe are instilling confidence not only with brokers but also with investors.

Q. Did you know during the past three or four years that the officers and directors of Federal Water Service Corporation were purchasing preferred stock of Federal Water Service Corporation? A. Yes, sir.

Q. Did you see any impropriety in that? A. No, sir.

• **Testimony of Christopher T. Chenery, July 23, 1940.**

2893 Re-direct examination

By Mr. Hubbard:

Q. Mr. Chenery, at the close of the last hearing you were being questioned with respect to the purchases by the Chenery Corporation. A. Yes.

Q. And these purchases are shown upon Applicant's Exhibit No. 33? A. Yes.

Q. Now I would like to take up these purchases with you and ask you as to the status of the plan at the time that these purchases were made.

Will you turn to Exhibit 33? Now according to this sheet, Chenery Corporation purchased 100 shares of stock on April 29, 1938. What was the status of the plan at 2894 that time? A. The first plan had been filed with the Commission, public hearings had been held; a complete disclosure of the position of the company, its earning position, its assets, its forecast of earnings, and everything in connection with it was on file with the SEC. There had been newspaper publicity, releases by the Commission, and complete information available to anybody who wanted it.

Q. And on April 8, 1938, you had a conference down here in Washington and had been told that the SEC would not recommend the plan? A. That is true.

Q. Now you purchased 50 shares of preferred stock—Chenery Corporation purchased 50 shares of Federal Water Service preferred stock, on May 3, 1938? A. Yes.

Q. Was the status of the plan the same? A. It was.

Q. May 6, 1938, 50 shares. Was the status of the plan the same? A. Yes.

Q. Now on August 18 you purchased—the Chenery Corporation purchased 30 shares of Federal Water Service Corporation preferred stock. What was the status of the plan at that time? A. The capital reduction plan 2895 had been filed, but we had been told that it was the

opinion of the staff that the prospects of its favorable reception were remote.

Q. A hearing had been held, had it not, on the capital reduction plan? A. Yes.

Q. As an alternative plan to the one filed on November 8, 1937? A. That is true.

Q. Now was the status of the two plans the same on August 19, 1938, when the Chenery Corporation purchased 20 shares? A. Yes.

Q. August 20, 1938, when the corporation purchased 13 shares? A. Yes.

Q. August 29, 1938, when the corporation purchased 9 shares? A. Yes.

Q. And September 1, 1938, the corporation purchased 188 shares. A. Yes. No change.

Q. The status of the plan was unchanged? A. No change.

Q. And on September 12, 1938, when the corporation purchased 100 shares? A. No change.

Q. And through the rest of September, 1938, there was no change? A. No change.

Q. Now on November 15, 1938, the corporation purchased 100 shares? A. Yes.

Q. What was the situation in November, 1938? I call your attention to the fact that the letter from Mr. Riter is dated November 28, 1938. A. Yes. There was no change in the situation.

Q. November 16, 1938? A. No change.

Q. November 18, 1938? A. No change.

Q. November 21, 1938? A. No change.

Q. December 2, 1938? A. We had had a conference with the staff, in a preliminary fashion, but quite inconclusive.

Q. The conference, I call your attention, did not take place until December 5. A. December 5?

Q. 1938. The conference had been arranged at that time. A. No change on that date.

Q. December 6, 1938, the corporation purchased 25 shares. That was the day after the conference in Wash-

ington, at which you were handed the memorandum by Mr. Fortas. A. Yes, and we were quite far apart.

Mr. Baldy: There were 35 shares purchased on that day.

Q. And then there was another 10 shares purchased on December 6, 1938, making 35 shares on December 6, 1938?

A. Yes.

Q. Now on March 20, 1939, the corporation, the Chenery Corporation, purchased 600 shares. A. That is true.

Q. Now prior to that purchase had any publicity been given out with respect to the filing of a new plan? A. The Wall Street Journal on February 15 had published a full and complete outline of the plan which was to be proposed.

Q. I show you a clipping from the Wall Street Journal as of February 15, 1939, and ask you if that is the statement to which you refer. A. That is the statement to which I refer.

Mr. Hubbard: I offer it in evidence.

(The Examiner: Admitted.)

(The document referred to was received in evidence as Applicant's Exhibit No. 38.)

2898 Q. At that time had any agreement been reached with the staff or with the Commission as to the approval of that plan which was referred to in the Wall Street Journal? A. No.

Q. Now on May 2, 1939, Chenery Corporation purchased 84 shares. A. Yes.

Q. What was the status of the plan at that time? A. Mr. Culin—I find I asked him to give me the dates of the conferences which he considered vital and which he testified might have an effect, and he thought that between the period April 28 and May 11 that the officers might have had special information which wasn't generally public. Now I would like to say in that that I don't think that the officers ever had information which wasn't generally available to stockholders. In fact, one of the dissenting stockholders, Mr. Russo, has always had much better informa-

tion than I have and he could tell us in advance what the situation would be, much more clearly and much more accurately than were our own views of it. Where he got it or how he got it, I have no knowledge. All I know is that he could and would and did on several occasions forecast correctly the action of the Commission, saying he could get information to that point.

Q. Now I call your attention to the fact that there was a conference here in Washington on April 26, 1939. I 2899 show you what purports to be a memorandum of that conference and ask you what the situation was with respect to the plan and the attitude of the Commission at that time.

The Witness: Will you read the question?

(The question was read by the reporter.)

Q. Do you recall having a conference with Judge Healy?

A. I do.

Q. Do you recall whether or not it was suggested to Judge Healy as a possible procedure that the Commission turn down both plans, if that was the view of the Commission, and in its order—state what plan would be satisfactory to the Commission? A. Yes.

Q. And Judge Healy thought that—or expressed himself, did he not, as thinking that that was worthy of consideration? A. Yes.

Q. Now was any tentative procedure with respect to plans discussed with the Commission at that conference on April 26, 1939? A. The procedure was discussed that the Commission could, in a report, if it denied two alternative plans which were then before it becoming effective, could suggest a third alternative plan. That was—

Q. (Interposing) Did you know on April 26, 1939, that the Commission was favorably disposed to the plan 2900 which was filed in May, 1939? A. No, I certainly did not.

Q. At that conference the possibility of purchasing preferred stock by the corporation was referred to, was it not?

A. It was.

Q. And that was the conference at which Mr. Spencer expressed himself as thinking that the suggestion was terrible? A. That is true.

Q. Now two days later what happened? A. I see by this list that Chenery Corporation bought—

Q. (Interposing) I meant with respect to the plans. A. Oh, with respect to the plan. Very much to my surprise, Mr. Spencer called me on the telephone.

Q. And advised you in substance as you have testified heretofore? A. That is correct.

Q. Now have you caused an investigation to be made as to the instructions which were given with respect to the purchase of the 84 shares of preferred stock on May 2, 1939? A. I have.

Q. Will you state what those instructions were? A. On April 26, 1939, two days before this, the corporation wrote a letter to Gilbert J. Postley.

Q. By "the corporation" you mean Chenery Corporation? A. The Chenery Corporation—which stated: "This will authorize you to sell for our account 250 shares of Alabama Water Service \$6 preferred stock, and to purchase with the funds from this sale Federal Water Service Corporation preferred stock on the basis of about four shares of Federal for one share of Alabama. Yours very truly, Chenery Corporation, Jacqueline Sanford, assistant secretary."

Q. And the 84 shares that were purchased were in pursuance of those instructions? A. Pursuance of those instructions.

Q. Now the next plan was filed on May 11, 1939, was it not? A. Yes.

Q. And on May 19, 1939, Chenery Corporation purchased 244 shares of preferred stock? A. That is right.

Q. Have you a record showing when publicity was given to that, to the filing of that plan? A. I have here Securities and Exchange Commission Holding Company Act Release No. 1536, dated May 16, 1939, covering the details of the plan.

Q. Chenery Corporation made purchases June 6, 1939, and June 29, 1939? A. That is true.

Q. And the status of the plan was that it was pending before the Commission at that time. A. That is true.

Q. The Havender decision in the Chancery Court of Delaware came down in the early part of June, 1939, did it not? A. That is my recollection. I haven't the definite date before me.

Q. I show you a memorandum of a conference held with the staff of the Securities and Exchange Commission on June 20, 1939, and ask you if that refreshes your recollection as to whether the decision on the Havender case in the Chancery Court had come down before that date. A. It had come down before June 20.

Q. I show you a memorandum of a conference in the office of the SEC on June 28, 1939, and ask you if that refreshes your recollection as to the status of plans at that time. A. It does.

Q. And what was the status at that time? A. The Havender decision had made the plan filed inapplicable, and the Commission staff was discussing with us filing under 11(c), isn't it?

Q. That was the first suggestion that you had received for reorganization of Federal Water Service Corporation under the Holding Company Act in the manner now permitted by Delaware corporation law? A. That is true. I modify that this way: that a day or two prior to 2903 this, suggestion had been made by telephone, but this was the first meeting of which I have a record at which we discussed it down here.

Q. Then on June 29, 1939, the status of the situation was that the plan before the Commission had been interfered with by the decision of the Delaware Court in the Haven-der case and a suggestion had been made by the staff of the SEC for reorganization under Section 11 (e)? A. That is true.

Q. And state whether or not it looked as if you were about as far away from a plan as ever. A. It did. It did so look. The opinion of our counsel was that the plan under 11 (e) was in conflict with Delaware law, and his advice to us was not to file such a plan.

Q. Now was that the status of the plan in July, 1939? A. That was the status—

Q. (Interposing) I am not overlooking the fact that there were various conferences with the SEC during that period— A. Yes.

Q. (Continuing)—but was anything conclusive reached? A. We had no thought of being able to agree with the SEC on the plan at that time. We seemed very far apart.

Q. But during that period you were attempting 2904 to work something out? A. We were attempting earnestly to work something out.

Q. Along the lines of the common stock plan? A. That is true.

Q. Either under 11 (e) or some other procedure? A. That is true.

Q. And was that the situation generally in August, 1939? A. August, 1939, we reinstated the capital reduction plan, because we could not agree with the staff of the Commission on the filing under 11 (e) plan, and because they insisted on our going to hearing on plans which were then pending, so their dockets could be closed.

Q. And you had a hearing on the capital reduction plan on August 29 and August 30, 1939? A. Yes. We had no reason to believe that the Commission would—

Q. (Interposing) Approve the plan? A. (Continuing)—approve the plan.

Q. But publicity had been given to the capital reduction plan through notice of hearing, had it not? A. Well, this was merely a reinstatement of the capital reduction plan which had been filed the year before, and publicity had been given at that time, about a month after the plan had been originally filed with the Commission.

Q. Now, was the situation approximately the same 2905 in September, 1939? A. Yes.

Q. And November, 1939? A. Yes.

Q. And in January, 1940, on January 3, 1940? A. Up until the reversal of the ~~Flavender~~ case in January, 1940.

Mr. Hubbard: Off the record.

(Discussion off the record.)

Q. Mr. Chenery, there appears on Exhibit 33 that Chenery Corporation made a purchase of 2700 shares of Federal Water Service preferred stock in exchange for \$100,000 par value of Federal Water debentures. You have heard Mr. Ingalls' testimony this morning with respect to that transaction? A. Yes.

Q. Will you state the circumstances of that transaction? A. My recollection of it doesn't differ in any substantial particular from Mr. Ingalls'.

Ingalls & Snyder had acquired a large block of preferred stock, some in their own hands, some in the hands of their clients. Postley had a substantial block of preferred stock, some in his own hands and some in the hands of his clients. The suggestion had been made that that block might be used as a basis of control and sold to some group who might 2906 desire control and that it might be a profitable thing to the holders of that stock if they so did.

They asked what we thought about it, and I expressed the opinion that it was their own stock, they bought it and paid for it and could do as they pleased, but if they asked me whether I would consider it a friendly thing to attempt to go out and sell control of the company that I wouldn't regard it as a friendly action.

Well, they said our position was very weak and that we ought to have more stock, which I agreed. We discussed the purchase with them—or the exchange, rather, of a hundred thousand Federal debentures for this stock.

I thought the market was pretty jittery and would get more so and that they wouldn't want to hold very large blocks of stock for which there was no market, wouldn't want to be tied up with it, especially with Italy heading for war, and that it was to the advantage of our group to buy this stock, buy it not for quick profits, because that was never inherent in the purchase at any time—no one who wanted quick profits would tie up large sums of money in Federal Water Service preferred stock, especially if he was an officer and director and would be prohibited from getting out in a six-months' period. The purchase obviously had to be to strengthen the position.

I think on one jittery day I suggested to Mr. Erskine that he tell them to exchange the debentures for 3000 2907 shares, and they thought that they would exchange for 2500 shares, and conversations jockeyed back and forth. Each time the market would go up a little bit, they would go down a few shares and each time it would go down we would want more. And then finally the day Italy declared war nobody knew what was going to happen; we came to an agreement on 2700 shares of 6½ equivalent preferred stock for the hundred thousand debentures.

Q. Now, Mr. Chenery, after these tentative findings and conclusions of law came down, request was made in behalf of the SEC, was it not, for opportunity to examine the broker's confirmation slips and all other memoranda with respect to the purchases by Chenery Corporation? A. It was.

Q. And representatives of the SEC came to New York to make the investigation? A. They did.

Q. Did you give them every facility? A. I think they will so testify.

Q. And you so testify? A. And I so testify.

Q. Just so the answer is complete: you gave them every facility to make any investigation they wanted to with respect to those purchases? A. I gave them—I did.

2908 Q. And how long were they in New York? A. I don't know. I saw them on two separate days. Whether they were there longer than that, I don't know.

Q. How many men? A. Three, I think.

Q. Now, Mr. Chenery, do you recall back in October, 1937, purchases of preferred stock at a market break? A. Very clearly.

Q. Did you consider there was any impropriety in making those purchases? A. I thought that we were rendering a real service to stockholders.

Q. In making the purchases? A. In making the purchases. The market dropped away. There were no bids. People had to sell the stock. Anybody who came in the market during that period with a bid for stock was rendering a service to the stockholder in that he was making a market which didn't then exist.

Q. Now after those purchases there was a hearing in Washington with respect to the plan filed on November 8, 1937? A. That is true.

Q. And the Class A stockholders were represented at that hearing by Mr. Levin? A. That is true.

Q. And Mr. Levin questioned you about those purchases? A. That is true.

Q. And undertook to criticize the purchases, is that correct? A. That is true.

Q. What did you think about that criticism? A. I thought it was unjust and unfair, and it rankled a great deal, and a plan had been filed, but it seemed to me that it was hitting a minor thing and giving it major importance. Plans are filed and are withdrawn, or something happens or doesn't happen, but the world goes on, wars are declared, markets break, earnings go up or earnings go down, and those are the things which affect your values, not the imminence of a plan.

I thought that this imminence—I knew a plan was to be filed in October, but I thought the filing of a plan in October, with a market break and values crashing all around; had nothing to do with the price of the stock, the price of the stock was reflecting the general break in the market, and that by purchasing at that time we were rendering a service to stockholders and we were also buying stock at a level which I considered cheap, but we were criticized.

Now I read this testimony again last night and it refreshed my recollection a good deal. I remember—

Q. (Interrupting) You mean you considered the testimony; you didn't read it, did you? A. I read the 2910 testimony last night.

Q. The testimony of the original hearing? A. 1937 hearing, yes. And it refreshed my recollection a good deal.

I think when that hearing was over and after that criticism had been made, which we considered unjust, we had a meeting on our offices, attended by our executives, and at that time we agreed that from then on we would not purchase stock or let stock be purchased at any time at which we could be criticized, even unfairly. That criticism had rankled enough so that we did not want to be in that position again.

The Examiner: Off the record.

(Discussion off the record.)

Q. What was the conference which you had at that office?

A. The conference was one of the executives of the corporation. I can't place the date of it; I was vague about it yesterday. Reading this testimony refreshed my recollection last night, and the effect of the conference was an understanding among all officers that no stock would be purchased at any time at which it could be said, fairly or unfairly, that we had more information than the general public.

Q. I think you testified yesterday that the details of those purchases were not handled by you. A. They were

2911 not handled by me, and I had no knowledge of the timing of the purchases.

Mr. Hubbard: I have no further questions.

Re-Cross Examination

By Mr. Baldy:

Q. Mr. Chenery, that conference to which you refer, at which you determined a policy to avoid purchases which might be criticized, what were the criteria that you determined upon by which you would judge whether a purchase was open to criticism or not? A. Whether we had information not generally available which would or could substantially affect the market price of the stock.

Q. What do you mean by "generally available"? You mean if somebody came down, if it was a matter of public record in the files of the SEC, then you were free to purchase? A. If it was a matter of public record in the files of the SEC and if there had been public announcement.

Q. And if there had been a public announcement? A. If there had been a public announcement, yes.

Q. Then you felt that it was entirely proper under those circumstances for you to avail yourself of information which had been given that degree of publicity? A. Yes, because that same information was available to anybody else who wanted it.

Testimony of Howard M. Erskine, July 23, 1940.

2916 Q. Mr. Erskine, you are an officer of Federal Water Service Corporation? A. I am.

2917 Q. What position do you hold? A. My particular duties are that relating to securities of the corporation itself, under the various subsidiary companies, the financing of all of the subsidiary companies, and in general the bonds and stocks of all subsidiary companies—that is, anything to do with refunding and refinancing is all in my department.

Q. You are vice-president of the company, are you not?

A. Yes, sir.

Q. And when did you become vice-president of Federal Water Service Corporation? A. I think in the spring of 1939.

Q. You are a director of Federal Water Service Corporation? A. I am now—pardon me: you said officer or director?

Q. I said vice-president. A. I became vice-president January 1, 1937. I am sorry.

Q. When did you become a director? A. I think in the spring of 1939.

Q. Now, Mr. Erskine, as part of your duties do you keep in touch with market conditions of Federal Water Service Corporation preferred stock and stocks of the subsidiaries, bonds of the corporation, and bonds of the subsidiaries?

A. Yes, sir.

Q. Will you state the number of dealers, in your 2918 judgment, who are interested in Federal Water Service Corporation stock? A. Well, I can only answer that very generally. I would say that from three or four or five in an inactive market to probably fifty in an active market. It would fluctuate, the number of dealers interested in the trading of those stocks would fluctuate with the activity in the market. ✓

Q. What do these dealers do in connection with purchases and sales of Federal Water Service Corporation preferred stock? A. Well, the Federal Water being an unlisted security, it is included in a list called the National Quotation Sheets, which list all of the securities of corporations where they are not listed on the New York Stock Exchange or on the New York Curb, and those are distributed very widely. I understand, throughout the whole country.

In addition to that, the National Association of Security Dealers I believe give to the various newspapers throughout the country quotations on over-the-counter securities, and among those Federal Water Service preferred stocks are invariably quoted.

Q. During the period from November 8, 1937, down to date, in your judgment was there plenty of preferred stock available to anyone who wanted to buy it? A. Yes, sir.

2919 Q. At the present time about how long do you think it would take to acquire 10,000 shares of Federal Water Service Corporation preferred stock at about the market price? A. It is a very difficult guess. I would guess from three to six months, but that would be governed by market conditions and many, many things.

Q. Now you from time to time were requested by the Chenery Corporation and other officers of Federal Water Service Corporation and its subsidiary companies to take some action with respect to purchases of preferred stock, were you not? A. That is true.

Q. And what did you do? A. Invariably, Mr. Hubbard—a typical example would be an officer or employee coming to me and asking what the market is on the stock. I would telephone or get for him the market on the stock, and he would indicate his desire to buy 10 shares or 50 shares or whatever it happened to be, and I would say, "That stock can be obtained from such-and-such a broker", and contacted the broker and the individual who wanted to buy the stock, and thereafter—

Q. (Interposing) Thereafter the negotiations were between the broker— A. (Interposing) Thereafter the confirmation, and so forth, would be between the broker and the individual.

2920 Q. How much time do you suppose this service, if we may call it such, took you in the course of a day?

A. Oh, probably a couple of telephone calls, Mr. Hubbard—a very few minutes. I didn't devote any time to it particularly.

Q. Now you have heard Mr. Ingalls testify with respect to his almost daily calls to you. What was the nature of those telephone calls? A. Mainly to give me various quotations. I have an early morning, as soon as the market

opens, several brokers who call me, probably four or five, who will call me on quotations on various securities as applied to the Federal Water Service System. We are always interested in where our bonds of subsidiary companies, our Federal bonds, our stocks of subsidiary companies are selling; and I receive those quotations, jot it on a piece of paper on my desk.

That is the prime motive for the conversations. There might be a few seconds of general conversation—sometimes, in the case of Mr. Ingalls, a few questions whether there is anything new in the situation, the Federal situation, and we have general conversation.

Q. Is the contact which you have with Mr. Ingalls in this regard any different from that with a number of other brokers? A. Oh, no. No, no.

2921—Q. How many houses do you suppose you have such connections with? Is it practically all of those who are actively engaged in making a market for Federal Water Service Corporation preferred stock? A. Yes, sir. The calls from dealers will probably fluctuate with the market activity, or with any publicity that is given earnings of the various subsidiary companies, or publicity as to the plan, if you will.

Q. Is it general practice in New York City for banks and brokerage houses and investment companies to call you up and ask you questions about the company? A. Yes; not only New York City, but out of town, also.

Q. Can you give us a typical example of the way that thing works? A. Well, a typical example would be that a firm in Portland, Maine, will call and say, "I have an inquiry from a customer who owns some—or wants to buy some New York Water preferred stock. Is there anything new in that situation, or anything that I can tell him?"

I say—well, if there is, I will probably tell him; if there isn't I probably won't, if there is nothing new in the situation. If earnings have been published and if he hasn't the latest earnings, I will send them to him.

Q. Have you ever suppressed any information from any stockholder or investment house or broker or any body who asked you for information? A. Certainly not, knowingly.

Q. You endeavor to give him as accurate a picture of the situation as you know? A. I usually tell him what I know, Mr. Hubbard, entering no opinion one way or the other on the purchase or sale of securities.

Q. Well, do you always do it?

The Witness: Will you read my last answer?

(The answer was read by the reporter.)

A. Always tell him—I correct that to “always”.

Q. You don't know of any time when you had information and you were asked about it that you didn't give it, do you? A. No, sir.

Q. It is a policy of the company, and has been since you have been connected with it— A. (Interposing) Yes, sir.

Q. (Continuing) —to give absolutely all information which the officers and directors have to an inquiring person? A. That is correct.

Q. Now, Mr. Erskine, do you recall a conversation as to the officers and directors purchasing preferred stock at times when they might have information which was not known to other people with respect to plans or other circumstances? A. Yes, sir.

2923 Q. What was said at that conference? A. The first conference was held, as has been testified, after the hearing of 1937, in which the purchases by officers was criticized, and we simply decided that we would not be subject to criticism and that we would not purchase securities when the public did not have full—the same information that we had regarding the plan or any other situation.

Q. And there was another conference, was there, at some subsequent time? A. Yes, sir. I have a memorandum of another conference held in January, 1939, which memorandum shows that such conference was held with Mr. Chen-

ery, Mr. Culin, and Mr. Mellenry and myself, regarding the purchase of preferred stock at that particular time. And it was decided at that time that we should continue to follow our policy of not purchasing stock so long as the public did not have the same information that we did, and at that particular conference there was a—the proposition under discussion was released, I find, on February 15, in the Wall Street Journal: that was the green light, was February 15, after the publicity was in the Wall Street Journal.

Q. According to Exhibit No. 33, Mr. Erskine, you purchased 50 shares of Federal Water Service Corporation preferred stock on September 7, 1938, and 25 shares 2924 on September 27, 1938. A. That is correct.

Q. Do you know of any impropriety in connection with that purchase? A. I felt no such impropriety, no, sir.

Q. Why did you make the purchase? A. Briefly, I thought the stock was cheap, and I was interested in being a member of the group who owned the stock in order that we should all have a continuing voice in the management of the business.

Q. Have you made a comparison between the prices of Federal Water Service Corporation preferred stock as quoted in the market and the Dow-Jones averages? A. I did.

Q. What did that comparison show? A. Comparison shows me that the price of the Federal preferred stock followed very closely the Dow-Jones averages up until December, January—December, 1939—January, 1940.

The Examiner: Off the record.

(Discussion off the record.)

The Witness: They are called Dow-Jones averages. Whether they are only industrial averages or not, I don't know. They are contained in a chart published by the Institute of Applied Econometrics, of New York City. And also in this chart, I might add, there is another line 2925 entitled "Major Business Trend", which is a scien-

title curve of the trend of business as it is and as it has been over a period of years, and in December, 1939—January, 1940, it appears that the price of the Federal stock went against the market. It went up and the market stayed steady until May, but during that period all utility stocks and bonds were very strong—it was a utility market, in other words, when all utilities went against the market, so that Federal Water Service in that instance followed closely all utilities.

Q. What conclusion do you draw from that comparison?

A. I conclude that, first, that the purchase of preferred stock by the officers, directors, and employees of the corporation had no effect whatever upon the market. It leads me to the conclusion that there was a slight flurry in the market—saw-toothed, in other words, in the chart.

2950 Mr. Hubbard: It is hereby stipulated between counsel for the applicant and counsel for the Commission that there be incorporated in the record the Commission's File No. 39-1-1, being reports filed with the Securities and Exchange Commission on form U17-1 and U17-2, by officers and directors, Federal Water Service Corporation and Utility Operators Company.

It is not, however, necessary to copy this file into the transcript of the record.

APPLICANT'S EXHIBIT NO. 33 (DOCKET NO. 81).

**PREFERRED STOCK OF FEDERAL WATER SERVICE CORPORATION
PURCHASED BY OFFICERS AND DIRECTORS OF
FEDERAL AND UTILITY OPERATORS COMPANY
FROM NOVEMBER 8, 1937 TO JUNE 30, 1940**

	Div. Rate <u>Pd.</u>	Date of <u>Purchase</u>	Number of <u>Shares</u>	Price <u>per Share</u>	<u>Total Cost</u>
J. H. Greene	\$6.00	2/1/39	45	\$21.25	\$ 956.25
W. R. Edwards	6.00	10/4/38	100	19.25	1,925.00
G. H. Chomery	6.50	9/13/38	25	19.75	493.75
	6.50	9/26/38	25	19.00	475.00
	6.50	10/3/38	25	18.50	462.50
	6.00	10/4/38	25	18.75	468.75
	6.50	11/9/38	25	23.50	587.50
	6.00	11/18/38	25	21.25	531.25
	6.00	11/23/38	10	19.50	195.00
	6.00	11/29/38	20	19.50	390.00
	6.50	12/5/38	25	19.50	487.50
	6.50	5/3/39	25	25.25	631.25
	6.00	1/9/40	70	34.00	2,380.00
			<u>300</u>	Av. 23.075	<u>7,102.50</u>
H. G. Calder	6.50	9/12/38	40	21.50	860.00
G. C. Harren	6.50	9/12/38	10	21.50	215.00
C. P. Rather	6.50	9/7/38	200	21.50	4,300.00
	6.50	11/16/38	100	21.50	2,150.00
	6.00	1/25/40	100	34.00	3,400.00
	6.50	5/24/40	10	36.50	365.00
	6.00	5/24/40	10	35.50	355.00
			<u>420</u>	Av. 25.167	<u>10,570.00</u>
R. H. Neilson	6.00	10/26/38	10	22.25	222.50
Wm. R. Matthews, III	6.50	9/8/38	65	21.50	1,397.50
H. T. Ellwood	6.50	9/30/38	38	18.50	703.00
	6.50	10/3/38	12	19.75	237.00
	6.00	1/3/40	30	34.00	1,020.00
			<u>80</u>	Av. 24.50	<u>1,960.00</u>

Wm. E. Matthews, III	6.50	9/8/38	<u>65</u>	21.50	<u>1,397.50</u>
H. T. Ellwood	6.50	9/30/38	38	18.50	703.00
	6.50	10/3/38	12	19.75	237.00
	6.00	1/3/40	30	34.00	1,020.00
			<u>80</u>	Av. 24.50	<u>1,960.00</u>
Watson Bark	6.50	9/1/38	5	21.50	107.50
	6.00	10/24/38	5	22.25	111.25
	6.50	11/21/38	5	20.50	102.50
	6.50	4/14/39	15	21.75	326.25
	6.50	4/14/39	10	21.25	212.50
	6.50	4/24/39	25	21.50	537.50
	6.50	5/2/39	25	23.25	581.25
	6.50	5/2/39	25	23.50	587.50
	6.50	9/19/39	50	21.50	1,075.00
	7.00	10/3/39	60	27.00	1,620.00
			<u>225</u>	Av. 23.38-1/3	<u>5,261.25</u>
E. C. Deal	6.00	10/4/38	10	17.25	192.50
	6.00	11/23/38	25	20.00	500.00
	6.00	2/6/40	50	35.25	1,762.50
			<u>85</u>	Av. 28.888	<u>2,455.00</u>

Mr. G. H. Chemistry also has a beneficial interest in the securities owned by Chemistry Corporation.

	<u>Div.</u> <u>Rate</u> <u>Pd.</u>	<u>Date of</u> <u>Purchase</u>	<u>Number of</u> <u>Shares</u>	<u>Price</u> <u>per Share</u>	<u>Total Cost</u>
H. M. Brakins	\$6.50	9/7/38	50	\$21.90	\$ 1,075.00
	6.00	9/27/38	25	16.50	412.50
			75	Av. 19.833	1,487.50
F. T. Tansill	6.50	9/1/38	50	21.50	1,075.00
	6.50	11/28/39	15	26.00	390.00
			65	Av. 22.538	1,464.00
Loren Fitch	6.00	11/23/38	1	20.00	20.00
F. R. Harris	6.00	1/31/39	40	22.25	890.00
	6.00	2/1/39	90	22.75	2,047.50
	6.50	1/11/39	18	23.25	418.50
	6.50	2/1/39	155	23.75	3,681.25
	7.00	1/11/39	25	24.75	618.75
	7.00	2/1/39	15	25.25	378.75
			243	Av. 23.425	5,634.75
W. A. Gulin	6.50	9/3/38	50	21.50	1,075.00
	6.50	11/9/38	10	23.50	235.00
	6.50	11/28/39	50	26.00	1,300.00
	6.00	1/4/40	50	33.00	1,650.00
			160	Av. 26.425	4,260.00
H. D. McHenry	6.50	9/7/38	50	21.50	1,075.00
	6.50	11/4/39	25	25.00	625.00
	7.00	1/10/40	15	36.50	547.50
			90	Av. 24.972	2,247.50

C. van den Berg, Jr.

6.50	12/13/37	203	23.87 1/2	4,846.63
6.50	12/15/37	45	21.25	956.25
6.50	12/17/37	120	22.64-7/12	2,717.50
6.50	12/20/37	20	21.90	430.00
6.50	1/3/38	25	21.50	537.50
6.50	3/2/38	50	23.00	1,150.00
6.50	3/3/38	33	23.00	759.00
6.50	3/4/38	17	23.00	391.00
7.00	5/10/38	28	21.25	595.00
7.00	5/12/38	87	22.75	1,979.25
6.50	5/10/38	47	20.00	940.00
6.50	7/20/38	20	20.25	405.00
6.50	7/25/38	40	20.25	810.00
6.50	10/25/38	100	22.75	2,275.00
6.50	10/28/38	250	22.90	5,725.00
6.50	10/31/38	3	20.75	62.25
7.00	11/3/38	25	25.25	631.25
6.50	11/3/38	100	24.00	2,400.00
6.50	11/9/38	100	23.50	2,350.00
6.50	11/21/38	75	20.25	1,518.75
6.50	11/30/38	50	19.75	987.50
6.50	12/1/38	7	19.67 1/2	84.75
6.50	12/3/38	24	19.6303	1,645.25
6.50	11/22/39	100	26.00	2,600.00
		1,675	Av. 22.543	37,799.13

3270

80

	Div. Rate Pfd.	Date of Purchase	Number of Shares	Price per Share	Total Cost
Owned by Chenery Corporation, a corporation wholly owned by C. T. Chenery and members of his family (in- cluding Mr. C. M. Chenery)	\$6.00	4/29/38	30	\$16.90	\$ 495.00
	7.00	4/29/38	30	19.00	570.00
	7.00	4/29/38	40	18.90	740.00
	7.00	5/3/38	25	18.00	450.00
	7.00	5/3/38	25	18.00	450.00
	6.00	5/6/38	50	18.90	925.00
	6.90	8/18/38	20	20.75	415.00
	6.90	8/18/38	10	20.75	207.50
	6.90	8/19/38	20	20.75	415.00
	6.90	8/20/38	13	20.75	269.75
	6.90	8/29/38	9	20.90	184.50
	6.00	9/1/38	188	20.00	3,760.00
	6.90	9/12/38	100	21.125	2,112.50
	6.90	9/15/38	50	20.90	1,025.00
	6.90	9/15/38	70	19.25	1,347.50
	6.90	9/23/38	170	19.00	3,230.00
	6.90	9/28/38	25	18.90	462.50
	6.90	9/30/38	35	19.00	665.00
	6.00	11/15/38	100	21.125	2,112.50
	6.90	11/16/38	100	21.00	2,100.00
	6.00	11/18/38	100	20.90	2,090.00
	6.00	11/21/38	75	20.90	1,537.50
	6.00	12/2/38	50	19.00	950.00
	6.90	12/6/38	25	21.75	543.75
	6.90	12/6/38	10	22.75	227.50
	6.90	3/20/39	450	23.00	10,350.00
	7.00	3/20/39	150	23.00	3,450.00
	6.90	5/2/39	84	21.1607	1,777.50
	6.90	5/19/39	244	24.3196	5,933.98
	6.90	6/6/39	84	23.988	2,015.00
	6.90	6/29/39	12	20.665	247.98
	6.90	6/29/39	120	20.665	2,479.80
	6.00	7/5/39	115	21.5174	2,474.50
	6.00	7/6/39	25	22.00	550.00
	6.90	7/6/39	25	22.25	556.25
	6.90	7/6/39	30	23.25	697.50
	6.00	7/21/39	40	24.75	990.00
	6.00	7/21/39	50	24.75	1,237.50
	6.00	7/24/39	20	24.75	495.00
	6.00	7/25/39	100	24.75	2,475.00
	6.00	7/25/39	67	25.00	1,675.00
	6.00	7/25/39	50	24.75	1,237.50
	6.90	7/25/39	75	25.25	1,893.75
	6.90	7/26/39	12	25.25	303.00
	6.00	7/26/39	33	24.90	808.50

6.50	7/27/39	30
6.50	7/29/39	15
6.50	7/31/39	35
6.00	8/1/39	80
6.00	8/1/39	20
6.00	8/1/39	25
6.00	8/2/39	30
6.00	8/2/39	15
6.50	8/2/39	15
6.50	8/3/39	6
5.00	8/3/39	8
6.00	8/3/39	16
6.00	8/3/39	25
6.00	8/7/39	200
6.00	8/11/39	175

24.50	808.50
25.00	750.00
24.25	363.75
24.75	866.25
24.25	1,940.00
24.00	480.00
24.50	612.50
25.00	1,250.00
24.75	247.50
25.25	378.75
26.50	159.00
25.50	204.00
25.75	412.00
26.00	650.00
25.50	5,100.00
25.50	4,462.50

3271

	Div. Rate Pct.	Date of Purchase	Number of Shares	Price per Share	Total Cost
Chemery Corp. (continued)	\$6.00	8/15/39	45	\$25.50	\$ 1,147.50
	6.50	8/15/39	224	26.00	5,824.00
	6.50	8/16/39	109	26.00	2,834.00
	6.00	9/22/39	150	21.25	3,187.50
	6.00	9/25/39	75	21.25	1,593.75
	7.00	9/27/39	110	23.00	2,530.00
	6.00	9/28/39	26	22.25	578.50
	6.00	9/29/39	10	24.50	245.00
	6.00	10/11/39	65	25.00	1,625.00
	6.00	10/13/39	25	24.75	618.75
	6.00	10/16/39	25	24.50	612.50
	6.00	10/17/39	10	24.75	247.50
	6.00	10/19/39	10	24.75	247.50
	6.00	10/19/39	100	25.00	2,500.00
	6.00	10/21/39	50	24.75	1,237.50
	6.00	10/23/39	75	25.00	1,875.00
	6.00	10/23/39	39	25.00	975.00
	6.00	10/23/39	17	25.00	425.00
	6.50	10/23/39	22	25.25	555.50
	6.50	10/23/39	40	25.375	1,015.00
	6.00	10/24/39	12	24.75	297.00
	6.00	10/24/39	22	25.00	550.00
	6.00	10/24/39	25	24.75	618.75
	6.00	10/25/39	25	25.25	631.25
	6.00	10/25/39	80	25.25	2,020.00
	6.00	10/25/39	10	25.00	250.00
	6.50	10/25/39	20	25.50	510.00
	6.00	10/27/39	30	25.375	761.25
	6.00	10/31/39	18	25.00	450.00
	6.00	10/31/39	50	25.25	1,262.50
	6.00	10/31/39	50	26.00	1,300.00
	6.50	11/2/39	100	24.875	2,487.50
	7.00	11/2/39	50	25.50	1,275.00
	6.00	1/3/40	308	34.70	10,472.00
				Av. 25.6216	
	6.00	5/10/40	751		
	6.50	6/10/40	1,138		
	7.00	6/10/40	751		100,000.00
				Av. 27.866	\$ 240,148.02

*All of these transactions reflected the exchange of \$100,000 principal amount of 5½% Debentures for an aggregate of 2700 shares of preferred stock of the various series indicated, without payment or receipt of any cash consideration.

APPLICANT'S EXHIBIT NO. 36 (DOCKET NO. 84).

TRANSFERS OF FEDERAL PREFERRED DURING 1936 - 1940

	<u>1936</u>	<u>1937</u>	<u>1938</u>	<u>1939</u>	<u>6 mos. 1940</u>
\$6	55,946	33,755	17,755	31,138	20,685
\$6.50	54,345	36,505	18,171	27,818	15,596
\$7	11,068	7,365	3,961	3,875	3,083
\$4	<u>430</u>	<u>350</u>	<u>251</u>	<u>189</u>	<u>95</u>
Total transfers	121,789	77,975	40,138	65,020	39,459

Purchases by
officers and
directors of
Federal and
Utility Opera-
tor Company

170	1,465	3,653	5,023	3,343
-----	-------	-------	-------	-------

Traded by
Gilbert J.
Postley & Co.

5,820	14,468	28,458	22,529
			(to 7/18/40)

Excerpts from Exhibit B-96.

**1073 INFORMATION REQUIRED BY RULES OF
THE SECURITIES AND EXCHANGE COMMISSION**

The directors of Federal Water Service Corporation are: C. T. Chenery, Walter A. Culin, H. M. Erskine, 90 Broad Street, New York City, W. Findlay Downs, Packard Building, Philadelphia, Pa., Harry O. King, 420 Lexington Avenue, New York City, and Edward W. Robinson, 27 William Street, New York City.

The directors of Utility Operators Company are: E. C. Deal, M. A. Boylan, 135 Jefferson Ave., Scranton, Pa., C. P. Rather, J. N. Greene, L. O. Gordon, H. Gordon Calder, W. E. Matthews, III, C. G. Herren, Watts Building, Birmingham, Alabama, C. T. Chenery, C. M. Chenery, Walter A. Culin, H. T. Ellwood, H. M. Erskine, Russell H. Neilson, Frederic T. Tansill, 90 Broad Street, New York City, William R. Edwards, Triangle Building, Rochester, 1074 N. Y., Watson A. Dark, Washington Avenue & 15th

Street, Miami Beach, Florida, and Frank Sutters, c/o California Water Service Company, San Jose, California.

The directors of Federal Water and Gas Corporation are: Walter A. Culin, H. D. McHenry and Frederic T. Tansill, 90 Broad Street, New York City.

The officers of Federal Water Service Corporation are: C. T. Chenery, President, Walter A. Culin, Vice President and Treasurer, Frederic T. Tansill, Vice President and Secretary, H. D. McHenry and H. M. Erskine, Vice Presidents, Loren Fitch, Assistant Secretary and Assistant Treasurer, and John V. van Pelt, III, Assistant Treasurer.

The officers of Utility Operators Company are: C. T. Chenery, President, E. C. Deal, J. N. Greene, W. E. Matthews, III, Russell H. Neilson and C. P. Rather, Vice Presidents, Frederic T. Tansill, Secretary and Treasurer, and Loren Fitch, Assistant Secretary and Assistant Treasurer.

The officers of Federal Water and Gas Corporation are: Walter A. Culin, President, H. D. McHenry, Vice President, Frederic T. Tansill, Secretary and Treasurer.

In addition to the foregoing, Frederic R. Harris was a director of Federal Water Service Corporation from March 22, 1944 to June 10, 1941 and Cornelius van den Berg, Jr. was a director of Federal Water Service Corporation from January 11, 1937 to January 10, 1941. Cornelius van den Berg, Jr. was also Vice President of Federal Water Service Corporation from January 1, 1937 to January 10, 1941 and Vice President and director of Utility Operators Company from March 28, 1932 to July 31, 1941.

3977 **Application by Chenery Corporation, et al. for Leave to Intervene, and Request for Reconsideration and Relief.**

(filed August 15, 1941)

Now come Chenery Corporation, H. M. Erskine, R. H. Neilson, W. A. Culin, F. T. Tansill, H. D. McHenry, T. H. Wiggin, C. M. Chenery, J. N. Greene, H. G. Calder, C. P. Rather, William E. Matthews, H. C. van den Berg, Jr., W. R. Edwards, Watson Dark, E. C. Deal, F. R. Harris, and E. C. Elliott, hereinafter called "interveners", and make application for permission to intervene in the above entitled proceeding, and as reason therefor state:

1. Chenery Corporation is a corporation organized under the laws of Delaware with offices at 1 Exchange Place, Jersey City, New Jersey, and is a stockholder
3978 in Federal Water Service Corporation (hereinafter called "Federal"). The President of Chenery Corporation is C. T. Chenery, who is also the President and a director of Federal and of Utility Operators Company (hereinafter called "UOC"). Chenery Corporation has outstanding 22,937 shares of stock of which 9,637 shares are owned by C. T. Chenery, 1,100 shares are owned by

C. M. Chenery, who is a director of UOC, 1,100 shares are owned by William L. Chenery, 1,100 shares are owned by Alan J. Chenery, 1,100 shares are owned by Blanche B. Perrin, 600 shares are owned by Hollis Burnley Chenery, 600 shares are owned by Margaret Emily Chenery, 600 shares are owned by Helen Bates Chenery (Jr.), and 7,100 shares are owned by Helen Bates Chenery. The stockholders of Chenery Corporation other than C. T. Chenery and C. M. Chenery are not officers or directors of Federal, of UOC or of Federal Water and Gas Corporation (hereinafter called "FW & G").

2. The interveners other than Chenery Corporation are officers or directors of Federal, UOC, and FW & G, as follows: H. M. Erskine is Vice President and a director of Federal. R. H. Neilson is a director and Vice President of UOC. W. A. Culin is Vice President, Treasurer, and a director of Federal, a director of UOC and the President and a director of FW & G. F. T. Tansill is Vice President and Secretary of Federal, Secretary and Treasurer and a director of UOC, and Secretary and Treasurer and a director of FW & G. H. D. McHenry is a Vice President of Federal and a Vice President and director of FW & G. T. H. Wiggin is a former director of UOC. C. M. Chenery is a director of UOC. The address of the seven persons just named is 90 Broad Street, New York City. J. N. Greene is a director and Vice President of UOC. H. G. Calder is a director of UOC. C. P. Rather is a director and Vice President of UOC. William E. Matthews, III is a director and Vice President of UOC. C. van den Berg, Jr. is a former Vice President and director of Federal and a former Vice President and director of UOC. The address of the five persons just named is Watts Building, Birmingham, Alabama. W. R. Edwards is a director of UOC, address Triangle Building, Rochester, New York. Watson Dark is a director of UOC, address Miami Beach, Florida. E. C. Deal is a Vice Presi-

dent and director of UOC, address 135 Jefferson Avenue, Scranton, Pennsylvania. F. R. Harris is a former director of Federal, address 27 William Street, New York City. E. C. Elliott is a former director of UOC, address San Francisco, California.

3. These proceedings involve applications and declarations having as their primary object the reorganization of Federal pursuant to a plan contemplating the merger of UOC, the parent of Federal, and FW & G, a wholly owned subsidiary of Federal, into Federal. In the above entitled proceeding Federal filed (File No. 34-9) an application pursuant to Rule U-12E-4 for a report on a plan for its reorganization; and a declaration pursuant to Rule U-12E-5 with respect to solicitation of consents to this plan. UOC filed (File No. 34-41) a similar application and declaration. Federal and UOC jointly filed (File No. 79-28) a declaration pursuant to Section 7 with respect to the alteration of rights of their security holders and the issuance of new securities incident to the proposed merger. FW & G filed (File 34-9) a declaration pursuant to Section 7 with respect to alteration of rights of the holder of its securities incident to the proposed merger. This declaration adopts the application and declaration filed by Federal and UOC and asks that FW & G be made a party thereto. The first plan was filed in these proceedings November 8, 1937. Successive amendments have been filed to the application and declarations, and the proceedings are still pending, no final order having been entered therein.

4. During the period from November 8, 1937, to June 30, 1940, these interveners purchased preferred stock in Federal in amounts as follows:

Name	\$6.00 Preferred	Shares \$6.50 Preferred	\$7.00 Preferred
J. N. Greene	45	1	..
W. R. Edwards	100	..	..
H. G. Calder	..	40	..
C. P. Rather	110	310	..
R. H. Neilson	10	..	..
Wm. E. Matthews III	..	65	..
Watson Dark	5	160	60
E. C. Deal	85	..	..
H. M. Erskine	25	50	..
F. T. Tansill	..	65	..
F. R. Harris	130	173	40
W. A. Culin	50	110	..
H. D. McHenry	..	75	15
Chenery Corporation	3860	3547	1211
T. H. Wiggin	50	30	..
E. C. Elliott	27	..	..
C. M. Chenery	150	170	..
C. van den Berg, Jr.	25	1535	140

C. M. Chenery has sold 125 shares of the \$6.00 preferred stock and 20 shares of the \$6.50 preferred stock, C. van den Berg, Jr. has sold 25 shares of the \$6.00 preferred stock and 700 shares of the \$6.50 preferred stock.

5. These proceedings have been pending before the Commission since November 8, 1937, and numerous hearings have been had thereon. March 24, 1941, the Commission filed its findings and opinion therein (Holding Company Act Release No. 2635). The plan then under consideration had contemplated, among other features, the conversion of Federal 7 preferred, \$6.50 preferred, \$6.00 preferred and \$4.00 preferred into new common stock. In its find-

3982 ings and opinion filed March 24, 1941, the Commission stated that the plan of reorganization could not be approved in so far as it provided for participation of preferred shares purchased by officers or directors of Federal or UOC, or by the Chenery Corporation after November 8, 1937, on a parity with other shares of preferred stock

of the same series. The Commission found that "the provisions for participation by the preferred stock held by the management result in the terms of issuance of new securities being detrimental to the interest of investors and the plan being unfair and inequitable". Entry of an order was deferred, and it was stated that further consideration would be given to the matter if Federal filed amendments to its proposed plan designed to cure this and other alleged defects therein.

6. Thereafter amendments to the declarations and applications setting for the plan of reorganization were filed by the corporations involved in order to comply with the said findings and Opinion of the Commission as interpreted by the staff of the Commission. Paragraph Fourth (a) of the proposed merger agreement as set forth in the last amendments (see No. 15) reads as follows:

FOURTH: The manner of converting the shares of capital stock of each of the constituent corporations into 3983 share of stock of the surviving corporation shall be as follows:

(d) No shares of common stock of the surviving corporation shall be issued in lieu of the shares of preferred stock of Federal Water Service Corporation, purchased since November 8, 1937 by Chenery Corporation, or since November 8, 1937 the following persons when they were officers or directors of Federal Water Service Corporation or Utility Operators Company and which are owned by them on the effective date of the merger agreement: J. N. Greene, W. R. Edwards, C. M. Chenery, H. G. Calder, C. P. Rather, R. H. Neilson, Wm. E. Matthews, III, Watson Dark, E. C. Deal, H. M. Erskine, F. T. Tansill, F. R. Harris, W. A. Culin, H. D. McHenry, T. H. Wiggin, E. C. Elliott and C. van den Berg, Jr. Each such holder shall be entitled to receive and the surviving corporation shall be obligated to pay, upon the surrender of the certificates of such stock to the surviving corporation, the actual cost

of such stock to such holder, together with interest thereon at four per cent per annum from the dates of its or his purchase of such stock to the effective date of the merger agreement. In ascertaining cost of preferred stock acquired by exchange of other securities for purposes of this provision, the fair market value at the date of exchange of the securities given in exchange shall be deemed to be the cost of such preferred stock. In the event any shares of preferred stock of Federal Water Service Corporation purchased by Chenery Corporation or by the said officers or directors of Federal Water Service Corporation or Utility Operators Company since November 8, 1937, shall have been sold by such corporation or individual prior to the effective date of the merger agreement, the surviving corporation shall, upon the surrender of the remaining such shares owned by such corporation or individual, be obligated to pay to such corporation or individual a sum equal to the actual cost of all preferred stock of Federal Water Service Corporation purchased by it or him since November 8, 1937, together with interest thereon at four per cent per annum from the dates of its or his purchase of such stock to the effective date of the merger agreement minus the proceeds of the sale by it or him of any such shares together with interest thereon at four per cent per annum from the dates of its or his sale of such stock to the effective date of the merger agreement. The shares of preferred stock to be acquired by the surviving corporation pursuant to this subdivision (d) of the merger agreement consists of 4,522 shares of preferred stock of Federal Water Service Corporation of the \$6 series, 5,610 shares of the \$6.50 series and 1,466 shares of the \$7 series.

Upon being informed by the staff of the Securities and Exchange Commission in April, 1941, that in its opinion the persons who are now interveners should execute agreements obligating them to hold the preferred stock purchased by them after November 8, 1937, for a reasonable

time so that such stock would not be sold in the market, the intervenor executed agreements in form satisfactory to the staff of the Commission, which provide that the intervenor should hold such stock and should not sell the same until November 1, 1941, unless prior to that time the merger agreement should become effective or be abandoned. The agreements contain the express statements that they should not at any time be construed as or deemed an admission that such stock was in any way different from or entitled to any different or other rights than the preferred stock of the same series owned by any other holder and each agreement provides:

"3. That this instrument shall not be construed as a waiver of any right I may have to review in the manner provided by law any decision of the Securities and Exchange Commission or to take such action as I may be advised to protect my rights as they may be established on such review."

The proceedings are now pending before the Commission on the plan of reorganization as so amended. A further hearing thereon was held August 12, 1941, and no final decision has been made.

7. The intervenors are advised that the findings and opinion of the Commission of March 24, 1941, above described are erroneous, and that the preferred stock purchased by them should be treated in the reorganization on the same basis as preferred stock held by other stockholders. An argument to that effect was made by counsel for the corporations who are parties to these proceedings prior to the said findings and opinions of March 24, 1941, but after said findings and opinions were filed the corporations filed amendments to the proposed plan of reorganization, as set forth in Paragraph 6 hereof, and their counsel are now advocating the approval of the plan as so amended. At this time there is no one representing the interest of the intervenors. The intervenors are advised that they possess a legitimate interest which is inadequately represented,

within the meaning of Rule 17 of the Rules of Practice of the Commission, and they desire to intervene herein.

3986 At the hearing on August 12, 1941, C. T. Chenery appeared as President of the Chenery Corporation, and W. A. Culin, F. T. Tansill and H. M. Erskine appeared personally. Mr. Chenery then stated that he had made arrangements for a lawyer to appear on his behalf and on behalf of the other persons referred to in Paragraph Fourth (d) of the proposed merger agreement, who are the present interveners, in order that they might object to that paragraph, ask for a rehearing with respect to the propriety of that paragraph, and if necessary have any order of the Commission approving the paragraph reviewed in the manner provided by the Act. Mr. Chenery stated that he had been informed on August 8, 1941, that the lawyer in question could not appear because of a possible conflict of interest, and that there had not been sufficient time before the hearing to obtain other counsel. Mr. Chenery stated that as President of Chenery Corporation he objected to Paragraph Fourth (d) of the proposed merger agreement and asked for reconsideration by the Commission and he requested that he be given an opportunity to retain counsel. Mr. Tansill, Mr. Culin and Mr. Erskine individually joined in Mr. Chenery's objection on behalf of the Chenery Corporation. The examiner then announced that the case would be kept open until August 16, 1941, in order to allow the

3987 Chenery Corporation and other preferred stockholders in the same class to file a petition for intervention and a petition for rehearing. Thereafter on August 12, 1941, said preferred stockholders retained the firm of Covington, Burling, Rublee, Acheson & Shorb, of Washington, D. C., who theretofore had taken no part in the proceedings and who had no knowledge of the facts involved.

8. The interveners object to the approval of any plan of reorganization containing a provision similar to that of Paragraph Fourth (d) of the proposed merger agreement

set forth in Paragraph 6 hereof, or in accordance with the opinion of the Commission expressed March 24, 1941, to the effect that the preferred stock purchased by the interveners should be treated on a less favorable basis than other preferred stock. They respectfully represent that the entry of an order approving a plan containing such a discriminatory provision would be unfair, inequitable, and detrimental to the interests of investors and would be erroneous and illegal. These interveners state that they have duly reported to the Commission all purchases of the preferred stock in question while they were directors or officers of the corporations in question. They state that Section 17 of the Public Utility Holding Company Act of 1935 provides that directors and officers shall report to the Commission their purchases of stock in registered holding companies 1988 and shall account for profits on sales made within six months of the purchase thereof, but such Act contains no prohibition of the purchase of stock by officers or directors and imposes no liability in regard to stock purchased and held for more than six months. They are advised and therefore allege that no principle of common or statutory law or equity forbids directors or officers of a corporation from purchasing stock therein, whether or not an application contemplating reorganization is under submission to the Securities and Exchange Commission.

Wherefore the interveners pray:

1. That this application to intervene be allowed, and that the interveners be made parties to the above entitled proceeding.
2. That counsel for the interveners be allowed a reasonable time to file briefs in support of the contentions made by the interveners herein and that oral argument thereon be allowed before the Commission, but no request is made for leave to take additional testimony.
3. That the case be reconsidered by the Commission to the extent that the present holding treats stock held by

these applicants on a different basis from other preferred stock.

3989 . 4. That the Commission enter findings and opinion to the effect that the plan should be modified so that these interveners shall be treated in the same manner as other holders of preferred stock, and that the Commission deny effectiveness to the declarations herein unless they are so modified.

5. And for such other and further relief as may be appropriate.

Respectfully submitted,

COVINGTON, BURLING, RUBLEE,
ACHESON & SHORB,

Union Trust Building, Washington, D. C.,
Attorneys for

Chenery Corporation, H. M. Erskine,
R. H. Neilson, W. A. Culin, F. T. Tansill,
H. D. McHenry, T. H. Wiggin,
C. M. Chenery, H. N. Greene, H. G. Calder,
C. P. Rather, Wm. E. Matthews III,
C. van den Berg, Jr., W. R. Edwards,
Watson Dark, E. C. Deal, F. R. Harris, and E. C. Elliott.

SPENCER GORDON,
WM. MERRICK PARKER,

Union Trust Building,
Washington, D. C.,

Of Counsel.

3990 District of Columbia: ss.

W. A. Culin being duly sworn says that he is one of the interveners and that he makes this affidavit in his own behalf, as a preferred stockholder in Federal Water Service Corporation, and on behalf of the other preferred stockholders thereof who are named as interveners in the application for leave to intervene to which this affidavit is

attached. He makes this affidavit on behalf of the other interveners because they are absent from the District of Columbia.

The interest of the interveners arises by reason of the fact that the merger agreement as now proposed contemplates the sale to Federal Water Service Corporation of certain preferred stock held by the interveners therein, all as more fully set forth in the application for leave to intervene to which this affidavit is attached. The position which this affiant and the other interveners propose to take with respect to the pending matter has heretofore been taken by the corporations, but at the present time said corporations are taking a position which is adverse to the interests of this affiant and the other interveners all as more fully set forth in said application for leave to intervene and there is no one in the case representing the interveners.

3991 This affiant, W. A. Culin, has read the application for leave to intervene to which this affidavit is attached, he states that he verily believes that the facts stated in said application are true and he makes said application a part of this affidavit without repeating the same herein.

W. A. CULIN.

Subscribed and sworn to before me this 15th day of August, 1941.

MARJORY E. WOOD,
Notary Public, D. C.

My commission expires July 15, 1944.

Order Granting Application to Intervene.

(filed August 18, 1941)

3992

United States of America

Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 18th day of August, A. D. 1941.

In the Matter of

**FEDERAL WATER SERVICE CORPORATION
UTILITY OPERATORS COMPANY
FEDERAL WATER AND GAS CORPORATION**

File Nos. 34-9

34-41

70-28

(Public Utility Holding Company Act of 1935)

Chenery Corporation, H. M. Erskine, R. H. Neilson, W. A. Culin, F. T. Tansill, H. D. McHenry, T. W. Wiggin, C. M. Chenery, J. N. Greene, H. G. Calder, C. P. Rather, William E. Matthews, III, C. van den Berg, Jr., W. R. Edwards, Watson Dark, E. C. Deal, F. R. Harris, and E. C. Elliott having, on August 15, 1941, filed an application to intervene and become parties to the above entitled proceeding;

It appearing from said application that said applicants do not desire to take additional testimony but wish to file briefs in support of their contentions and make oral argument thereon;

It is ordered that subject to all of the proceedings heretofore had said applicants be and hereby are permitted to intervene and become parties to the proceeding; and

It is further ordered that said intervenors have leave to file briefs in support of their contentions provided the same shall be filed on or before August 28, 1941; and

It is further ordered that leave to make oral argument be and hereby is denied, subject, however, to such further order, if any, as the Commission shall deem it appropriate to make in that regard after consideration of said briefs.

By the Commission.

FRANCIS P. BRASSOR,
Secretary.

Opinion of the Supreme Court.

4483 Supreme Court of the United States

No. 254.—October Term, 1942.

SECURITIES AND EXCHANGE COMMISSION, *Petitioner,*

v.

CHENERY CORPORATION, H. M. ERSKINE, R. H. NEILSON, ET AL.

On Writ of Certiorari to the United States Court of Appeals
for the District of Columbia.

[February 1, 1943.]

Mr. Justice Frankfurter delivered the opinion of the Court.

The respondents, who were officers, directors, and controlling stockholders of the Federal Water Service Corporation (hereafter called Federal), a holding company registered under the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C. § 79, brought this proceeding under § 24 (a) of the Act to review an order made by the Securities and Exchange Commission on September 24, 1941, approving a plan of reorganization for the company. Under the Commission's order, preferred stock acquired by the respondents during the period in which successive reorganization plans proposed by the management

of the company were before the Commission, was not permitted to participate in the reorganization on an equal footing with all other preferred stock. The Court of Appeals for the District of Columbia, with one judge dissenting, set the Commission's order aside, 128 F. 2d 303, and because the question presented looms large in the administration of the Act, we brought the case here. 347 U. S. —.

The relevant facts are as follows. In 1937 Federal was a typical public utility holding company. Incorporated in Delaware, its assets consisted of securities of subsidiary water, gas, electric, and other companies in thirteen states and one foreign country. The respondents controlled Federal through their control of its parent, Utility Operators Company, which owned all of the outstanding shares of Federal's Class B common stock, representing the controlling voting power in the company. On November 8, 1937, when Federal registered as a holding company under the Public Utility Holding Company Act of 1935, its management filed a plan for reorganization under §§ 7 and 4484 11 of the Act, the relevant portions of which are copied in the margin.¹ This plan, as well as two

¹ "Sec. 7. (a) A registered holding company or subsidiary company thereof may file a declaration with the Commission, regarding any of the acts enumerated in subsection (a) of Section 6, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. Such declaration shall include—

"(1) such of the information and documents which are required to be filed in order to register a security under Section 7 of the Securities Act of 1933, as amended, as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers; and

"(2) such additional information, in such form and detail, and such documents regarding the declarant or any associate company thereof, the particular security and compliance with such State laws as may apply to the act in question as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers.

"(d) If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

"(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

"(e) If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a

other plans later submitted by Federal, provided for participation by Class B stockholders in the equity of the proposed reorganized company. This feature of the plans was unacceptable to the Commission, and all were ultimately withdrawn. On March 30, 1940, a fourth plan was filed by Federal. This plan, proposing a merger of Federal, Utility Operators Company, and Federal Water and Gas Corporation, a wholly-owned inactive subsidiary of Federal, contained no provision for participation by the

privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

"(f) Any order permitting a declaration to become effective may contain such terms and conditions as the Commission finds necessary to assure compliance with the conditions specified in this section.

"SEC. 11. (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

"(c) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of Section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of Section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

Class B stock. Instead, that class of stock was to be surrendered for cancellation, and the preferred and Class A common stock of Federal were to be converted into common stock of the new corporation. As the Commission pointed out in its analysis of the proposed plan, "except for the 5.3% of new common allocated to the present holders of Class A stock, substantially all of the equity of the reorganized company will be given to the present preferred stockholders."

During the period from November 8, 1937, to June 30, 1940, while the successive reorganization plans were before the Commission, the respondents purchased a total of 12,407 shares of Federal's preferred stock. (The total number of outstanding shares of Federal's preferred stock was 159,269.) These purchases were made on the over-the-counter market through brokers at prices lower than the book value of the common stock of the new corporation into which the preferred stock would have been converted under the proposed plan. If this feature of the plan were approved by the Commission, the respondents through their holdings of Federal's preferred stock would have acquired more than 10 percent of the common stock of the new corporation. The respondents frankly admitted that their purpose in buying the preferred stock was to protect their interests in the company.

4486 In ascertaining whether the terms of the new common stock were "fair and equitable" or "detrimental to the interests of investors" within § 7 of the Act, the Commission found that it could not approve the proposed plan so long as the preferred stock acquired by the respondents would be permitted to share on a parity with other preferred stock. The Commission did not find fraud or lack of disclosure, but it concluded that the respondents, as Federal's managers, were fiduciaries and hence under a "duty of fair dealing" not to trade in the securities of the corporation while plans for its reorganization were before the Commission. It recommended that a formula be de-

vised under which the respondents' preferred stock would participate only to the extent of the purchase prices paid plus accumulated dividends since the dates of such purchases. Accordingly, the plan was thereafter amended to provide that the preferred stock acquired by the respondents, unlike the preferred stock held by others, would not be converted into stock of the reorganized company, but could only be surrendered at cost plus 4 percent interest. The Commission, over the respondents' objections, approved the plan as thus amended, and it is this order which is now under review.

We completely agree with the Commission that officers and directors who manage a holding company in process of reorganization under the Public Utility Holding Company Act of 1935 occupy positions of trust. We reject a lax view of fiduciary obligations and insist upon their scrupulous observance. See *Wormley v. Wormley*, 8 Wheat, 421, 441; *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 487-88; and see Stone, *The Public Influence of the Bar*, 48 Harv. L. Rev. 1, 8-9. But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?

The Commission did not find that the respondents as managers of Federal acted covertly or traded on inside knowledge, or that their position as reorganization managers enabled them to purchase the preferred stock at prices lower than they would otherwise have had to pay, or that their acquisition of the stock in any way prejudiced the interests of the corporation or its stockholders. To be sure, the new stock into which the respondents' preferred stock would be converted under the plan of reorganization would have a book value—which may or may not represent market value—considerably greater than the prices paid for the preferred stock. But that would equally be true

of purchases of preferred stock made by other investors. The respondents, the Commission tells us, acquired their stock as the outside world did, and upon no better terms. ~~The Commission dealt with this as a specific case, and not as the application of a general rule formulating rules of conduct for reorganization managers.~~ Consequently, it is a vital consideration that the Commission conceded that the respondents did not acquire their stock through any favoring circumstances. In its own words, "honesty, full disclosure, and purchase at a fair price" characterized the transactions. The Commission did not suggest that, as a result of their purchases of preferred stock, the respondents would be unjustly enriched. On the contrary, 4487 the question before the Commission was whether the respondents, simply because they were reorganization managers, should be denied the benefits to be received by the 6,000 other preferred stockholders. Some technical rule of law must have moved the Commission to single out the respondents and deny their preferred stock the right to participate equally in the reorganization. To ascertain the precise basis of its determination, we must look to the Commission's opinion.

✓The Commission stated that "in the process of formulation of a 'voluntary' reorganization plan, the management of a corporation occupies a fiduciary position toward all of the security holders to be affected, and that it is subjected to the same standards as other fiduciaries with respect to dealing with the property which is the subject matter of the trust." Applying by analogy the restrictions imposed on trustees in trafficking in property held by them in trust for others, *Michoud v. Girod*, 4 How. 503, 557, the Commission ruled that even though the management does not hold the stock of the corporation in trust for the stockholders, nevertheless the "duty of fair dealing" which the management owes to the stockholders is violated if those in control of the corporation purchase its stock, even at a fair price, openly and without fraud. The Commission

concluded that "honesty, full disclosure, and purchase at a fair price do not take the case outside the rule."

In reaching this result the Commission stated that it was merely applying "the broad equitable principles enunciated in the cases heretofore cited" namely, *Pepper v. Litton*, 308 U. S. 295; *Michoud v. Girod*, 4 How. 503, 557; *Magruder v. Drury*, 235 U. S. 106, 119-20, and *Meinhard v. Salmon*, 249 N. Y. 458. Its opinion plainly shows that the Commission purported to be acting only as it assumed a court of equity would have acted in a similar case. Since the decision of the Commission was explicitly based upon the applicability of principles of equity announced by courts, its validity must likewise be judged on that basis. The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based.

In confining our review to a judgment upon the validity of the grounds upon which the Commission itself based its action, we do not disturb the settled rule that, in reviewing the decision of a lower court, it must be affirmed if the result is correct "although the lower court relied upon a wrong ground or gave a wrong reason." *Helvering v. Gowran*, 302 U. S. 238, 245. The reason for this rule is obvious. It would be wasteful to send a case back to a lower court to reinstate a decision which it had already made but which the appellate court concluded should properly be based on another ground within the power of the appellate court to formulate. But it is also familiar appellate procedure that where the correctness of the lower court's decision depends upon a determination of fact which only a jury could make but which has not been made, the appellate court cannot take the place of the jury. Like considerations govern review of administrative orders. If an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service for an administrative judgment. For

purposes of affirming no less than reversing its orders, an appellate court cannot intrude upon the domain which Congress has exclusively entrusted to an administrative agency.

4488 If, therefore, the rule applied by the Commission is to be judged solely on the basis of its adherence to principals of equity derived from judicial decisions, its order plainly cannot stand. As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock.² The cases upon which the Commission relied do not establish principles of law and equity which in themselves are sufficient to sustain its order. The only question in *Pepper v. Litton*, 308 U. S. 295, was whether claims obtained by the controlling stockholders of a bankrupt corporation were to be treated equally with the claims of other creditors where the evidence revealed "a scheme to defraud creditors reminiscent of some of the evils with which 13 Eliz. c. 5 was designed to cope", 308 U. S. at 296. Another case relied upon, *Woods v. City Bank Co.*, 312 U. S. 262, held only that a bankruptcy court, in the exercise of its plenary power to review fees and expenses in connection with a reorganization proceeding under Chapter X of the Chandler Act, 52 Stat. 840, could deny compensation to protective committees representing conflicting interests. *Michoud v. Girod*, 4 How. 503, and *Magruder v. Drury*, 235 U. S. 406, dealt with the specific obligations of express trustees and not with those of persons in control of a corporate enterprise toward its stockholders.

Determination of what is "fair and equitable" calls for the application of ethical standards to particular sets of facts. But these standards are not static. In evolving

² See I Dodd and Baker, *Cases on Business Associations* (1940) 489-500, 583-86, 621-22; 1 Morguetz on *Private Corporations* (2d ed. 1896) §§ 516-21, pp. 482-89.

standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law. But the Commission did not in this case proffer new standards reflecting the experience gained by it in effectuating the legislative policy. On the contrary, it explicitly disavowed any purpose of going beyond those which the courts had theretofore recognized. Since the Commission professed to decide the case before it according to settled judicial doctrines, its action must be judged by the standards which the Commission itself invoked. And judged by those standards, i. e., those which would be enforced by a court of equity, we must conclude that the Commission was in error in deeming its action controlled by established judicial principles.

But the Commission urges here that the order should nevertheless be sustained because "the effect of trading by management is not measured by the fairness of individual transactions between buyer and seller, but by its relation to the timing and dynamics of the reorganization which the management itself initiates and so largely controls." Its argument lays stress upon the "strategic position enjoyed by the management in this type of 4489 reorganization proceeding and the vesting in it of statutory powers available to no other representative of security holders". It contends that these considerations warrant the stern rule applied in this case since the Commission "has dealt extensively with corporate reorganizations, both under the Act, and other statutes entrusted to it", and "has, in addition, exhaustively studied protective and reorganization committees", and that the situation was therefore "peculiarly within the Commission's special administrative competence".

In determining whether to approve the plan or reorganization proposed by Federal's management, the Commission could inquire, under §7 (d) (6) and (e) of the Act, whether the proposal was "detrimental to the public interest or the interest of investors or consumers", and, under §11 (e), whether it was "fair and equitable". That these provisions were meant to confer upon the Commission broad powers for the protection of the public plainly appears from the reports of the Congressional committees in charge of the legislation. The provisions of §7 were "designed to give adequate protection to investors and consumers . . . and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection against the deleterious practices which have characterized certain holding-company finance in the past." Sen. Rep. No. 621, 74th Cong., 1st Sess., p. 28. Similarly, the authority given the Commission by §11 was intended to be responsive to the demands of the particular situations with which the Commission would be faced: "Under these subsections [11 (d), (e), and (f)], Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities . . ." *Id.*, p. 33.

In view of this legislative history, reflecting the range of public interests committed to the care of the Commission, §17 (a) and (b), which requires officers and directors of any holding company registered under the Act to file statements of their security holdings in the company and provides that profits made from dealing in such securities within any period of less than six months shall inure to the benefit of the company, cannot be regarded as a limitation upon the power of the Commission to deal with other situations in which officers and directors have failed to measure up to the standards of conduct imposed upon them by the Act. The Act vests in the officers and directors of

a holding company registered under the Act broad powers as representatives of all the stockholders. Besides the Commission, only the management can, under §11, initiate a proceeding before the Commission to simplify the corporate structure and to effect a fair and equitable distribution of voting power among security holders. Only the management can amend the plan, and this it may do at any time; only the management can withdraw the plan, and this too it may do at will; and even after the Commission has approved a plan, it cannot be carried out without the consent of the management.

Notwithstanding §17 (a) and (b), therefore, the Commission could take appropriate action for the correction of reorganization abuses found to be "detrimental to the public interest or the interest of investors or consumers." It was entitled to take into account those more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Act of 1935 was designed to correct. See the concurring opinion of Judge Learned Hand in *Morgan, Stanley & Co. v. Securities Exchange Commission*, 126 F. 2d 325, 332.

4490 But the difficulty remains that the considerations urged here in support of the Commission's order were not those upon which its action was based. The Commission did not rely upon "its special administrative competence"; it formulated no judgment upon the requirements of the "public interest or the interest of investors or consumers" in the situation before it. Through its preoccupation with the special problems of utility reorganizations, the Commission accumulates an experience and insight denied to others. Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different. Whether and to what extent directors or officers should be prohibited from buying or selling stock of the

corporation during its reorganization, presents problems of policy for the judgment of Congress or of the body to which it has delegated power to deal with the matter? Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions unconcerned with the fairness of a particular transaction. But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not prescribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by §11 (e), promulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity. The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission.

In view of the conditions imposed by the Commission in approving the plan, it is clear that the respondents were charged with violation of a positive command of law rather than with any moral wrong. If there had been a wrong, it would be against the stockholders from whom they purchased the preferred stock at less than the book value of the new stock—which, as we have already said, may or may not be its real value. But the Commission did not regard such stockholders as beneficiaries of the respondents'

"trust" and hence entitled to restitution. The Commission did not undo the purchases deemed by it to have been made by the respondents in violation of their fiduciary obligations. Instead, the Commission confirmed the purchases and ordered that the stock be surrendered to the corporation.

Judged, therefore as a determination based upon judge-made rules of equity, the Commission's order cannot be upheld. Its action must be measured by what the Commission did, not by what it might have done. It is not for us to determine independently what is "detrimental to the public interest or the interest of investors or consumers" or "fair or equitable" within the meaning of §§7 and 11 of the Public Utility Holding Company Act of 1935. The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order as an appropriate safeguard for the interest protected by the Act. There must be such a responsible finding. Compare *United States v. Chicago, M., St. P. & P. R. Co.*, 294 U. S. 499, 510-511. There is no such finding here.

4491 Congress has seen fit to subject to judicial review such orders of the Securities and Exchange Commission as the one before us. That the scope of such review is narrowly circumscribed is beside the point. For the courts cannot exercise their duty of review unless they are advised of the considerations underlying the action under review. If the action rests upon an administrative determination—an exercise of judgment in an area which Congress has entrusted to the agency—of course it must not be set aside because the reviewing court might have made a different determination were it empowered to do so. But if the action is based upon a determination of law as to which the reviewing authority of the courts does come into play, an order may not stand if the agency has misconceived the law. In either event the orderly functioning of the process of review requires that the grounds upon

which the administrative agency acted be clearly disclosed and adequately sustained. "The administrative process will best be vindicated by clarity in its exercise." *Phelps Dodge Corp. v. Labor Board*, 313 U. S. 177, 197. What was said in that case is equally applicable here: "We do not intend to enter the province that belongs to the Board, nor do we do so. All we ask of the Board is to give clear indication that it has exercised the discretion with which Congress has empowered it. This is to affirm most emphatically the authority of the Board." *Ibid.* Compare *United States v. Carolina Carriers Corp.*, 315 U. S. 475, 488-90. In finding that the Commission's order cannot be sustained, we are not imposing any trammels on its powers. We are not enforcing formal requirements. We are not suggesting that the Commission must justify its exercise of administrative discretion in any particular manner or with artistic refinement. We are not sticking in the bark of words. We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.

The cause should therefore be remanded to the Court of Appeals with directions to remand to the Commission for such further proceedings, not inconsistent with this opinion, as may be appropriate.

So ordered.

Mr. Justice Douglas took no part in the consideration and decision of this case.

No. 254.—October Term, 1942.

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

CHENERY CORPORATION, H. M. ERSKINE, R. H. NEILSON, ET AL.

[February 1, 1943.]

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia.

Mr. Justice Black, with whom Mr. Justice Reed and Mr. Justice Murphy concur, dissenting.

For reasons set out in the Court's opinion and the dissenting opinion below, I agree that these respondents, officers and directors of the Corporations seeking reorganization, acted in a fiduciary capacity in formulating and managing plans they submitted to the Commission, and that, as fiduciaries, they should be held to a scrupulous observance of their trust. I further agree that Congress conferred on the Commission "broad powers for the protection of the public", investors and consumers; and that the Commission, not the Court, was invested by Congress with authority to determine whether a proposed reorganization or merger would be "fair and equitable", or whether it would be "detrimental to the public interest or the interest of investors or consumers."

The conclusions of the Court with which I disagree are those in which it holds that while the Securities and Exchange Commission has abundant power to meet the situation presented by the activities of these respondents, it has not done so. This conclusion is apparently based on the premise that the Commission has relied upon the com-

mon law rather than on "new standards reflecting the experience gained by it in effectuating legislative policy", and that the common law does not support its conclusion; that the Commission could have promulgated "a general rule of which its order here was a particular application", but instead made merely an ad hoc judgment; and that the Commission made no finding that these practices would prejudice anyone.

The Commission's actual finding was that "The plan of reorganization herein considered, like the previous plans filed with us over the past several years, was formulated by the management of Federal, and discussion concerning the reorganization of this corporation have taken place between the management and the staff of the Commission over the past several years;" that C. T. Chenery purchased 8,618 shares of preferred stock during this period; that other officers and directors of the concerns involved acquired 3,789 shares during the same period; that for this stock these respondent fiduciaries paid \$328,346.89 4493 and then submitted their latest reorganization plan, under which this purchased stock would have a book value in the reorganization company of \$1,162,431.90. In the light of these and other facts the Commission concluded that the new plan would be "unfair, inequitable, and detrimental so long as the preferred stock purchased by the management at low prices is to be permitted to share on a parity with other preferred stock." The Commission declined to give "effectiveness" to the proposed plan and entered "adverse findings" against it under §§7 (d) (1) and 7 (d) (2) of the controlling Act, resting its refusal to approve on this statement: "We find that the provisions for participation by the preferred stock held by the management result in the terms of issuance of the new securities being detrimental to the interests of investors and the plan being unfair and equitable."

The grounds upon which the Commission made its findings seem clear enough to me. Accepting as the Court does

the fiduciary relationship of these respondents in managing the Commission proceedings, it follows that their peculiar information as to the stock values under their proposed plan afforded them opportunities for stock purchase profits which other stockholders did not have. While such fiduciaries, they bought preferred stock and then offered a reorganization plan which would give this stock a book value of four times the price they had paid for it. What the Commission has done is to say that no such reward shall be reaped by these fiduciaries. At the same time they are permitted to recover the full purchase price with interest. To permit their reorganization plan to put them in the same position as the old stockholders gives to these fiduciaries an unconscionable profit for trading with inside information.

I can see nothing improper in the Commission's findings and determinations. On the contrary, the rule they evolved appears to me to be a salutary one, adequately supported by cogent reasons and thoroughly consistent with the high standards of conduct which should be required of fiduciaries. That the Commission saw fit to draw support for its own administrative conclusion from decisions of courts should not detract from the validity of its findings. Entrusted as the Commission is with the responsibility of lifting the standard of transactions in the market place in order that the managers of financial ventures may not impose upon the general investing public, it seems wholly appropriate that the Commission should have recognized the influence of admonitory language like the following it approvingly quoted from *Meinhard v. Salmon*, 249 N. Y. 458: "A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

The decisions cited by the Commission seem to me to show the soundness of the conclusion it reached. As judges we are entitled to a sense of gratification that the common law has been able to make so substantial a contribution to the development of the administrative law of this field. See e. g. *Pepper v. Littor*, 308 U. S. 295; *Michoud v. Girod*, 4 Howard 503; *Magruder v. Drury*, 235 U. S. 106. Of course the Commission is not limited to common law principles in protecting investors and the public but even if it were so limited the *Magruder* case would in my 4494 opinion provide complete support for the position taken by the Commission: "The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity. . . It makes no difference that the estate was not a loser in the transaction or that the commission was no more than the services were reasonably worth." pp. 119, 120. The distinction now seen by the Court between these cases and the instant problem comes to little more than that the fact situations are similar but not identical.

While I consider that the cases on which the Commission relied give full support to the conclusion it reached, I do not suppose, as the Court does, that the Commission's rule is not fully based on Commission experience. The Commission did not "explicitly disavow" any reliance on what its members had learned in their years of experience, and of course they, as trade experts, made their findings that respondent's practice was "detrimental to the interest of investors" in the light of their knowledge. That they did not unduly parade fact data across the pages of their reports is a commendable saving of effort since they meant merely to announce for their own jurisdiction an obvious rule of honest dealing closely related to common law standards. Of course, the Commission can now change the form of its decision to comply with the Court order. The Court can require the Commission to use more words; but it

seems difficult to imagine how more words or different words could further illuminate its purpose or its determination. A judicial requirement of circumstantially detailed findings as the price of court approval can bog the administrative power in a quagmire of minutiae. Hypercritical exactions as to findings can provide a handy but an almost invisible glide-way enabling courts to pass "from the narrow confines of law into the more spacious domain of policy." *Phelps-Dodge Corporation v. Labor Board*, *supra*, 194. Here for instance, the Court apparently holds that the Commission has full power to do exactly what it did; but the Court sends the matter back to the Commission to revise the language of its opinion, in order, I suppose, that the Court may reappraise the reasons which moved the Commission to determine that the conduct of these fiduciaries was detrimental to the public and investors. The Act under which the Commission proceeded does not purport to vest us with authority to make such a reappraisal.

That the Commission has chosen to proceed case by case rather than by a general pronouncement does not appear to me to merit criticism. The intimation is that the Commission can act only through general formulae rigidly adhered to. In the first place, the rule of the single case is obviously a general advertisement to the trade, and in the second place the briefs before us indicate that this is but one of a number of cases in which the Commission is moving to an identical result on a broad front. But aside from these considerations the Act gives the Commission wide powers to evolve policy standards, and this may well be done case by case, as under the Federal Trade Commission Act. *Federal Trade Commission v. Keppel & Bros.*, 291 U. S. 304, 310-312.

The whole point of the Commission finding has been lost if it is criticized for a failure to show injury to particular shareholders. The Commission holding is that it should not "undertake to decide case by case whether the management's trading has in fact operated to the detriment

of the persons whom it represents," because the "tendency to evil" from this practice is so great that the Commission desires to attach to it a conclusive presumption of impropriety.

The rule the Commission adopted here is appropriate. Protection of investors from insiders was one of the chief reasons which led to adoption of the law which the Commission was selected to administer.¹ That purpose can be greatly retarded by overmeticulous exactions, exactions which require a detailed narration of underlying reasons which prompt the Commission to require high standards of honesty and fairness. I favor approving the rule they applied.

4496

Filed Apr 5 1943

United States Court of Appeals
For the District of Columbia.

No. 8074

April Term, 1943

CHENERY CORPORATION ET AL., *Petitioners*,

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent*;FEDERAL WATER AND GAS CORPORATION, *Intervenor*.

Order on the Mandate of the Supreme Court

In pursuance of the mandate of the Supreme Court of the United States filed in this cause on March 11, 1943, it is now here ordered by this Court that the order of the Securities and Exchange Commission in this cause be, and it is hereby, set aside, and that this cause be, and the same

¹ "Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others." Report of the Senate Committee on Banking and Currency on Stock Exchange Practices, Report No. 1455, 73d Cong., 2d Sess.

is hereby remanded to the Securities and Exchange Commission for such further proceedings, not inconsistent with the opinion of the Supreme Court of the United States in this cause, as may be appropriate.

Per curiam.

Dated April 5, 1943.

A true Copy.

Test: JOSEPH W. STEWART

Clerk of the United States Court of Appeals
for the District of Columbia

**EXCERPTS FROM SUPPLEMENTARY PROCEEDINGS
BEFORE SECURITIES AND EXCHANGE COMMISSION.**

4022

Filed Apr 7 1943

United States of America
Before the Securities and Exchange Commission

In the Matter of

FEDERAL WATER SERVICE CORPORATION,
UTILITY OPERATORS COMPANY
FEDERAL WATER AND GAS CORPORATION

File Nos. 34-9, 34-41, 70-28

(Public Utility Holding Company Act of 1935)

**Application and Declaration of Federal Water and Gas
Corporation.**

1. On March 30, 1940 Federal Water Service Corporation, a registered holding company, amended pending applications and declarations filed with the Securities and Exchange Commission pursuant to the Public Utility Holding

Company Act of 1935 so as to submit to the said Commission a plan for the readjustment and simplification of the capital structure of Federal Water Service Corporation by means of a merger between Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation in accordance with the provisions of Section 59 of the General Corporation Law of the State of Delaware. Said plan and agreement of merger provided for equality of treatment of all preferred stock of Federal Water Service Corporation.

2. Hearings were held with respect to said plan, and on June 29, 1940 the Commission issued tentative findings in which the question was raised for the first time whether preferred stock which had been purchased by officers and directors of Federal Water Service Corporation and Utility Operators Company and by Chenery Corporation while plans of reorganization were pending before the Commission should be treated on any different basis from other preferred stock.

3. Following hearings on this question, on March 24, 1941, the Commission filed formal findings and an opinion in which it was stated, among other things, that the plan could not be approved in so far as it provided for participation of preferred shares purchased by officers or directors of Federal Water Service Corporation or Utility Operators Company, or by the Chenery Corporation after November 8, 1937 on a parity with other shares of preferred stock of the same class. It was stated that further consideration would be given to the matter if amendments to the proposed plan were filed designed to cure this and other alleged defects therein.

4. On July 1, 1941 in order to meet the views of the Commission and obtain its approval to the submission of a plan to stockholders, there was included in the proposed merger agreement, the following paragraph except for the last sentence which was supplied by subsequent amendment:

(d) No shares of common stock of the surviving corporation shall be issued in lieu of the shares of preferred stock of Federal Water Service Corporation purchased since November 8, 1937, by Chenery Corporation, or since November 8, 1937 by the following persons when they were officers or directors of Federal Water Service Corporation or Utility Operators Company and which are owned by them on the effective date of the merger agreement; J. N. Greene, W. R. Edwards, C. M. Chenery, H. G. Calder, C. P. Rather, R. H. Neilson, Wm. E. Matthews, III, Watson Dark, E. C. Deal, H. M. Erskine, F. T. Tansill, F. R. Harris, W. A. Culin, H. M. McHenry, T. H. Wiggin, E. C. Elliott and C. van den Berg, Jr. Each such holder shall be entitled to receive and the surviving corporation shall be obligated to pay, upon the surrender of the certificates of such stock to the surviving corporation, the actual cost of such stock to such holder, together with interest thereon at four per cent per annum from the dates of its or his purchase of such stock to the effective date of the merger agreement. In ascertaining cost of preferred stock acquired by exchange of other securities for purposes of this provision, the fair market value at the date of exchange of the securities given in exchange shall be deemed to be the cost of such preferred stock. In the event any shares of preferred stock of Federal Water Service Corporation purchased by Chenery Corporation or by the said officers or directors of Federal Water Service Corporation or Utility Operators Company since November 8, 1937, shall have been sold by such corporation or individual prior to the effective date of the merger agreement, the surviving corporation shall, upon the surrender of the remaining such shares owned by such corporation or individual, be obligated to pay to such corporation or individual a sum equal to the actual cost of all preferred stock of Federal Water Service Corporation purchased by it or him since November 8, 1937, together with interest thereon at four per cent

per annum from the dates of its or his purchase of such stock to the effective date of the merger agreement minus the proceeds of the sale by it or him of any such shares together with interest thereon at four per cent per annum from the dates of its or his sale of such stock to the effective date of the merger agreement. The shares of preferred stock to be acquired by the surviving corporation pursuant to this subdivision (d) of the merger agreement consist of 4,522 shares of preferred stock of Federal Water Service Corporation of the \$6 series, 5,610 shares of the \$6.50 series and 1,466 shares of the \$7 series."

5. As assurance to the Securities and Exchange Commission that the persons and corporation referred to in paragraph Fourth(d) above quoted of the merger agreement would not sell or otherwise dispose of their shares of preferred stock before the merger agreement became effective, each of the persons and the corporation referred to above executed an agreement to that effect, copy of which was filed with the Commission on July 1, 1941 and which provided, in part, as follows:

4925 " (3) That this instrument shall not be construed as a waiver of any right that I may have to review in the manner provided by law any decision of the Securities and Exchange Commission or to take such action as I may be advised to protect my rights as they may be established on such review."

6. On August 15, 1941, the persons and corporation referred to in paragraph Fourth(d) of the merger agreement applied to the Securities and Exchange Commission for leave to intervene and objected to the approval of any plan of reorganization containing a provision to the effect that the preferred stock purchased by them should be treated on a less favorable basis than other preferred stock of the same class. They asked that the case be reconsidered by the Commission to the extent that the holding by the Commission in its findings and opinion of March 24, 1941 treated stock held by them on a different basis from other

preferred stock, and that the Commission enter findings and an opinion to the effect that the plan should be modified so that they would be treated in the same manner as the other holders of preferred stock and that the Commission deny effectiveness to the declarations unless they were so modified.

7. On August 18, 1941 the Commission granted the application to intervene and permitted the filing of briefs.

8. On September 24, 1941, the Securities and Exchange Commission issued its supplemental findings and opinion approving the plan as filed and adhering to the views expressed in the original opinion that the stock of the persons and corporation referred to in paragraph Fourth(d) of the merger agreement could not receive equal participation with the preferred stock owned by others in 4026 Federal Water Service Corporation and issued its order granting the applications of Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation and permitting the declarations as amended to become effective forthwith. On September 24, 1941, the Commission also issued its report with respect to the plan which stated in part as follows:

"Under the plan about 11,600 shares of preferred stock purchased by officers and directors of Federal and Utility Operators Company during the pendency of reorganization are treated differently from the other shares of preferred stock. The Commission felt that because of the circumstances under which the shares were purchased, these holders could not equitably be permitted to realize any benefit by their acquisition. The plan accordingly provides that these shares will be purchased for cancellation by the reorganized corporation at cost, which amounts to about \$285,000, plus 4% interest from the dates of acquisition by the present holders to the date of the merger. The company's letter states that an appeal is anticipated as to this feature of the plan and that it is believed that if the Commission's decision is reversed, the preferred stock held by the man-

agement should be permitted to participate in the reorganization on the same basis as the other preferred stock."

9. On October 22, 1941 said persons and corporation referred to in paragraph Fourth (d) of the merger agreement filed a petition in the United States Court of Appeals for the District of Columbia, pursuant to Section 24 of the Public Utility Holding Company Act, to review the order of the Commission entered on September 24, 1941, and prayed in said petition that said order be modified or be set aside to the extent necessary to treat the petitioners on the same basis as other holders of preferred stock of Federal Water Service Corporation of the same class.

10. On October 28, 1941, stockholders meetings of Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation were 4027 duly held and by the vote in excess of two-thirds of the stock of each of the corporations involved, the merger agreement was duly approved and the agreement of merger, together with appropriate certificates, was filed in the office of the Secretary of State of Delaware and a certified copy thereof recorded in the Recorder's Office in Kent County, Delaware, on October 31, 1941. Resolutions were also duly adopted at the meeting of the stockholders of Federal Water Service Corporation pursuant to Section 28 of the Delaware Corporation Law reducing the amount of the capital of the corporation from \$31,391,873.25 to \$4,921,655; such reduction of capital to be effected by reducing the amount of capital represented by the shares of common stock of the par value of \$5 each authorized to be issued by the agreement of merger by the amount of the excess of capital represented by such shares over such par value, and an appropriate certificate of reduction of capital was executed and filed in the office of the Secretary of State of Delaware and a certified copy thereof recorded in the Recorder's Office in Kent County, Delaware, on October 31, 1941.

11. On November 7, 1941 a certificate of consummation of the reorganization and merger was filed with the Securities and Exchange Commission setting forth the facts with respect to the consummation of said merger which certificate is hereby incorporated by reference.

12. On April 27, 1942 the United States Court of Appeals for the District of Columbia reversed the order of the Securities and Exchange Commission and remanded the cause to the Securities and Exchange Commission for further proceedings in conformity with the opinion of the Court (128 F. (2d) 303).

4028 13. In July, 1942, the Securities and Exchange Commission applied to the Supreme Court of the United States for certiorari which was granted (317 U. S. X) and on February 1, 1943, the Supreme Court of the United States filed its opinion and order in the cause remanding the same to the Court of Appeals of the District of Columbia with directions to remand the cause to the Securities and Exchange Commission for such further proceedings not inconsistent with the opinion of the Supreme Court, as may be appropriate.

14. The Supreme Court of the United States has issued its mandate to the Court of Appeals for the District of Columbia and said Court has issued its order on said mandate setting aside the order of the Securities and Exchange Commission in the cause and remanding the cause to the Securities and Exchange Commission for such further proceedings not inconsistent with the opinion of the Supreme Court of the United States in the cause as may be appropriate.

15. The Supreme Court said in its opinion (87 L. Ed. 411, at p. 418):

"But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or

an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11(c), promulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity. The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission."

16. Paragraph Fourth(d) of the merger agreement was inserted therein upon the assumption that it was in accordance with the rights of the persons and corporation referred to in said paragraph. It has now been finally determined by the Supreme Court of the United States that paragraph Fourth(4) was not in accordance with the rights of such persons and corporation.

17. Upon information and belief, there is no ground upon which Federal Water and Gas Corporation can require said persons and corporation referred to in said paragraph Fourth(d) of the merger agreement to surrender their stock in Federal Water Service Corporation and receive the consideration therefor specified in paragraph Fourth(d) and said paragraph is illegal and in violation of the rights of the stockholders referred to therein and the error due to the inclusion in the said merger agreement of paragraph Fourth(d) should be corrected.

18. The annual meeting of stockholders of Federal Water and Gas Corporation will be held in accordance with the by-laws on May 26, 1943.

19. As an appropriate method of correcting the error caused by the inclusion of paragraph Fourth(d) in the merger agreement, Federal Water and Gas Corporation desires to submit to its stockholders at a special meeting to be called at the conclusion of the annual meeting resolutions providing for an amendment and correction of the merger agreement so as to conform said merger agreement to the rights of the holders of preferred stock of Federal

Water Service Corporation as determined by the 4030 Supreme Court of the United States and for an amendment and correction of the certificate of reduction of capital so as to conform said certificate of reduction of capital to the merger agreement as so amended.

20. Annexed hereto and made a part hereof are (A) proposed resolutions of directors calling the proposed special meeting of the stockholders and setting forth the proposed amendments or corrections and (B) balance sheet of Federal Water and Gas Corporation as of December 31, 1942 and proforma balance sheet as of the same date giving effect to the proposed amendments or corrections.

Wherefore Federal Water and Gas Corporation respectfully asks that an appropriate order be entered permitting to become effective this application and declaration and that the Commission take such other action with respect thereto as may be required by the Public Utility Holding Company Act of 1935 and the Rules of the Commission.

Dated, New York, N. Y., April 7, 1943.

**FEDERAL WATER AND GAS
CORPORATION**

By **WALTER A CULIN**
Vice President.

[Accompanying Exhibits to the Application have been omitted.]

**4040 Motion of Chenery Corporation, et al., Intervenor,
for Further Proceedings Pursuant to Mandate.**

Now Come Chenery Corporation, M. M. Erskine, R. H. Neilson, W. A. Culin, F. T. Tansill, H. D. McHenry, T. H. Wiggin, C. M. Chenery, J. N. Greene, H. G. Calder, C. P. Rather, William B. Matthews, III, C. van den Berg, Jr., W. R. Edwards, Watson Dark, E. C. Deal, F. R. Harris, and E. C. Elliott, intervenors in the above entitled proceeding, and, pursuant to the order of the United States Court of Appeals for the District of Columbia on the mandate of the Supreme Court of the United States, move that such further proceedings be had as may be necessary
4041 to treat these intervenors on the same basis as other holders of preferred stock of Federal Water Service Corporation of the same class.

Points and Authorities

Securities & Exchange Commission v. Chenery Corporation, et al., 317 U. S. — ; 63 S. Ct. Rep. 454 (Feb. 15, 1943).

Request for Oral Argument

It is requested that oral argument be allowed on this motion.

Respectfully submitted,

COVINGTON, BURLING, RUBLEE,

ACHESON & SHORB

Union Trust Building,

Washington, D. C.

Attorneys for Chenery Corporation,

et al., Intervenor.

SPENCER GORDON,

Of Counsel.

4267

Feb 8 1945

Findings and Opinion of the Commission

Simplification of Holding-Company System

Participation in Plan of Reorganization by Officers and Directors of Registered Holding Company in Respect of Securities Acquired During Reorganization Proceedings under Section 11

Amendment to plan of reorganization proposing participation by officers and directors of registered holding company in respect of securities acquired by them while acting as reorganization managers under Section 11 of the Act, which participation would be on a parity with publicly-held securities of the same class; in light of all the circumstances, held not to meet the "fair and equitable" standard of Section 11 (e) and to be detrimental to the public interest and the interest of investors under Section 7; further held that the plan previously approved (which limited participation in respect of the acquired securities to the cost thereof plus 4% interest, in cash) should be reapproved on the basis of proceedings held after remand by the Supreme Court.

Appearances:

Hughes, Hubbard & Ewing, by Allen S. Hubbard, for Federal Water and Gas Corporation.

Spencer Gordon and Virginia C. Duncombe, of Covington, Burling, Rublee, Acheson & Shorb, for Chenery Corporation and others, Interveners.

Maurice C. Kaplan and Winthrop T. Johnson, for the Public Utilities Division of the Commission.

Thomas J. Tingley, for William S. Fox, a stockholder.

4268 Federal Water & Gas Corporation ("Federal Water") has filed an application in this proceeding for approval of an amendment to the plan of reorganiza-

tion of its predecessor, Federal Water Service Corporation ("Federal"), under the Public Utility Holding Company Act of 1935. The amendment proposes that the merger agreement, which we heretofore approved and which has long since been consummated (except with respect to certain securities of Federal which are in controversy here) should now be altered so as to provide for the issuance of new common stock of the reorganized company for distribution to certain officers and directors (hereinafter referred to as "interveners"),¹ *pari passu* with public investors, in respect of shares of old preferred stock acquired by such officers and directors during the period in which the management of Federal was proposing successive plans of reorganization for the approval of this Commission.

The interveners join with Federal Water in asking that the proposed amendment be approved. Counsel for our Public Utilities Division and counsel for William S. Fox, a holder of common stock of Federal Water and formerly a holder of Class A stock of Federal, oppose the application. Briefs have been filed and oral argument heard.

In our opinion of March 24, 1941, we disapproved an identical provision in the plan then before us for the reason, among others, that it was unfair and inequitable, and detrimental to the interests of investors. Federal Water Service Corporation, et al., 8 S. E. C. 893, 915-21 (1941).

Thereafter, the plan was amended to provide that the shares acquired by the interveners during the reorganization might be surrendered to the reorganized company for cash in the amount of their cost plus 4% interest from the dates of purchase to the date of consummation of the plan. Over the objection of the interveners, we approved the plan as modified. *Id.*, 10 S. E. C. 200 (1941).

¹ These were officers and directors of Federal, of certain of its subsidiaries, of its corporate parent Utility Operators Company, and also include Chenery Corporation, the personal holding company of Federal's president, C. T. Chenery. They intervened in 1941, prior to our approval of the plan of merger (*infra*).

Upon review by the United States Court of Appeals for the District of Columbia, our decision on this feature of the plan was reversed. *Chenery Corporation, et al. v. S. E. C.* 128 F. (2d) 303 (App. D. C., 1942), Miller, J., dissenting. On certiorari the Supreme Court expressed disagreement with some of the views of the Court of Appeals, but disagreed also with the reasoning on which we based our conclusion. *S. E. C. v. Chenery Corporation, et al.* 18 4269 U. S. 80, 87 L. Ed. 626 (1945), Black, Reed, and Murphy, JJ., dissenting. The Supreme Court neither reversed nor affirmed, but remanded the case to the Court of Appeals with directions to remand to the Commission for such further proceedings, not inconsistent with the Supreme Court's opinion, as may be appropriate. Thereupon the Court of Appeals set aside our order and remanded the cause to us.

On April 17, 1944, we issued an order denying the present application on the basis of findings and opinion simultaneously issued.² Upon objections thereto we decided to reopen the proceedings for further argument, and accordingly suspended the effectiveness of our order.³ Having heard such argument we have determined that our findings and opinion of April 17, 1944, should be withdrawn and the following substituted therefor.

As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to reexamine the case to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified.

² Holding Company Act Release No. 4957.

³ Holding Company Act Release No. 5090, June 7, 1944.

The question that we have to consider is whether the plan before us, as it would be amended in accordance with the present application, in the particular circumstances of the case, meets the standards prescribed by the Holding Company Act. It is not, and was not previously, a question of prescribing a standard of conduct generally applicable to trading by corporate officers, directors and large stockholders.

Before we can approve the amendment to the plan, whereby the preferred shares in question would participate on a parity with the publicly held shares, we are required by Section 11 (e) of the Act to find affirmatively that the plan, amended as proposed, is "fair and equitable" to the persons affected by it; and we cannot give it our approval if we find that component parts thereof are "detrimental to the public interest or the interest of investors or consumers" within the meaning of Sections 7 (d) (6) and 7 (e) of the Act, or would result in an "unfair and inequitable distribution of voting power" within the meaning of Section 7 (e).

In seeking the solution to these problems we turn first to a re-examination of the record in this case.

Statement of Facts

I. History and Description of Federal

Federal was incorporated on June 21, 1926, under the laws of Delaware to hold the securities of water, gas and electric utility operating companies. Voting control of Federal was lodged in Class B common stock which had been originally issued for a cash consideration of \$2,475,000 and which was held by Tri-Utilities Company, a public-

* The applicability of Section 11 standards to Federal's plan was discussed in our previous opinion, 8 S. E. C. 893, especially at 903-904, 921-923. Cf. also *Engineers Public Service Company*, — S. E. C. — (1942), *Holding Company Act Release No. 4114*; *Central and South West Utilities Company*, — S. E. C. — (1942), *Holding Company Act Release No. 3580*, affirmed 136 F. (2d) 273 (App. D. C., 1943); *National Power & Light Company*, 10 S. E. C. 827, 831 (1941).

utility holding company. Preferred and Class A common stocks with limited voting rights were issued and sold to the public.

Tri-Utilities pledged the Class B stock with Central Hanover Bank & Trust Co. and the Chase National Bank as security for loans. In 1931 Tri-Utilities went into receivership and the banks undertook to sell the Federal Class B stock at public auction.⁵

At that juncture, C. T. Chenery, who had been president of Federal since its incorporation, arranged with other officers, directors and employees of Federal and its subsidiaries to purchase the Federal Class B stock from the banks, in separate transactions. This program they ultimately carried out between 1932 and 1934 at a net cash cost of about \$605,249. The purchases were made by Utility Operators Company ("Operators"), which Chenery and the others had formed to hold the Federal Class B stock and to issue its own capital stock to the various participants.⁶

At the time our proceeding began the interveners held about one-third of Operators' stock, including the approximately 16% which was held by Chenery, individually and through Chenery Corporation.⁶ The balance of Operators' stock was distributed among approximately 1,700 persons most of whom, at the time, were still employees of Federal and its subsidiaries.

4271 *II. Conditions Requiring Reorganization of Federal*

On November 8, 1937, Federal registered with this Commission as a holding company subject to the Act. At that time Federal controlled a public-utility system of 42 subholding and operating subsidiaries which operated water,

⁵ Between 1933 and 1936 Operators also acquired 6,500 shares Federal's preferred stock, about which no issue was raised in this proceeding.

⁶ The interveners also held 2,500 shares of Federal's preferred stock acquired prior to the commencement of the proceeding. We permitted these shares to be treated on a parity with publicly held shares.

gas, electric and other properties in 13 states and 1 foreign country.⁷

Federal's capitalization at the time (based upon a financial statement dated September 30, 1937) was as shown in Table I (below).

4272

TABLE I

Federal Water Service Corporation Capitalization September 30, 1937	
5½% Gold Debentures, due 1934	\$6,893,500
Capital Stock:	
Preferred Stocks*:	
\$4 Cumulative, no par value, stated at \$62.50 per share—2,379 shares (Dividend arrears \$57,096—\$24½ per share)	\$148,687
\$6 Cumulative, no par value, stated at \$95 per share—71,706 shares (Dividend arrears \$2,581,416—\$36 per share)	6,812,070
\$6.50 Cumulative, no par value, stated at \$95.8574 per share—69,888 shares (Dividend arrears \$2,725,632—\$39 per share)	6,699,282
\$7 Cumulative, no par value, stated at \$100 per share—15,296 shares (Dividend arrears—\$642,432—\$42 per share)	1,529,600
Total	15,99,639
Class A, Cumulative, no par value, stated at \$24.03078 per share** Outstanding—568,775 shares (Dividend arrears at \$2 per annum, \$6,920,096—\$12.16 per share)	13,666,733
Class B, no par value, stated at \$4.6087 per share—542,450 shares	2,300,000
Total Common Stock	\$16,166,733
Total Capitalization	\$38,249,872

* Involuntary liquidating preference for the preferred stocks was \$100 per share, plus accrued dividends, except the \$4 series, which had an involuntary liquidating preference of \$62.50 per share, plus accrued dividends.

** Upon liquidation, the Class A stock was entitled to receive, subject to the prior rights of the preferred, \$50 per share, plus accumulated dividends, and thereafter to share equally with the Class B stock in any remaining assets.

4273 Dividend requirements on Federal's preferred stock aggregated about \$1,000,000 per annum and on the Class A stock about \$1,137,000 per annum. No dividends had been paid on any class of stock since 1931, and at November 7, 1937, arrearages amounted to nearly \$6,000,000 on the preferred stock and approximately

⁷ There were, in addition, some 65 small inactive subsidiaries which were kept alive to maintain franchises.

\$7,000,000 on the Class A stock. Federal's earned surplus deficit meantime increased each year, from \$568,266 at December 31, 1932, to \$2,411,272 at December 31, 1937. As of December 31, 1937, the net deficit in Federal's surplus accounts was equal to approximately half the stated value of the Class B stock. According to financial statements filed with this Commission at the time Federal registered, the fair value of Federal's investments in its subsidiaries was disclosed to be at least \$5,000,000 less than the \$35,477,170 at which they were carried.⁸ This capital impairment prevented the payment of dividends out of current income of \$712,746 received during 1936 and 1937.

Normally the Class B stock had the entire voting power except with respect to the creation of liens, the issuance of prior preferred stock and the election of three of the seven directors. Because of dividend arrearages on the preferred and Class A stocks, the Class B stock in 1937 had 42.73% of the total voting power, the Class A had 44.80%, and the preferred had 12.47%. The preferred and Class A shares were widely distributed among approximately 16,000 public stockholders, however, and Operators, the holder of the Class B stock, as a fact had full control of Federal and its operating subsidiaries.

III. Preregistration Plans of Reorganization

Prior to Federal's registration under the Holding Company Act, its officers and directors had proposed two plans of reorganization under Delaware law designed to cure the capital impairment and thereby release current earnings for payment of dividends. The First Plan, proposed in October 1936, did not provide for payment of the accumulated dividends on the preferred and Class A stocks and was abandoned following the decision of the Supreme Court of Delaware in *Keller v. Wilson & Company*, 190 Atl. 115

⁸ In an appraisal report filed by the company at the same time, the fair value of Federal's investments was stated to be fully \$10,000,000 less than carrying value.

(Del. 1936). The Second Plan, discussed informally with members of the Commission's staff during the summer of 1937, contemplated a reduction of the capital represented by the outstanding shares pro rata among the various classes. This plan was adversely criticized by the Commission's staff on the ground that it was designed to reduce the capital represented by the outstanding preferred and Class A shares far below their liquidating preferences. Thereafter Federal's officers and directors "considered further the possibility of formulating a practical 4274 plan of reclassification of stock and reduction of capital which would not only accomplish the objects sought by a reduction of capital but would also bring applicant's capital in line with the present value of its assets and its earning power and the provisions of" the Holding Company Act.

IV. Post-Registration Plans of Reorganization

Federal registered with the Commission on November 8, 1937. Between that date and March 30, 1940, Federal submitted four plans of reorganization, all containing provisions designed to cure the impairment of capital and permit the payment of dividends. The First Plan was submitted November 8, 1937, following informal discussion with the Commission's staff, as a proposal under Section 6 (a) (2) of the Holding Company Act "to alter the priorities, preferences, voting power or other rights of the holders" of its outstanding classes of stock. The plan provided for a reclassification of the outstanding classes of stock and a reduction of the stated capital. The Second Plan, filed on May 19, 1938, proposed merely a reduction of capital by reducing prorata the amount of stated capital in respect of the outstanding classes of stock. The Third Plan, filed on May 11, 1939, after extensive discussion with the Commission's staff, like the first, provided for a reclassification of the stock and a reduction of the capital. Although the Commission issued no opinion or order with

respect to the first three plans, the First and Second Plans were adversely criticized by members of the staff and it was understood by the management that the basic objection was to the giving of any interest in assets, earnings or voting power to the Class B stock. It was the staff's position that the Class B stock was worthless, while the management believed that although the Class B stock had no asset coverage or applicable earnings it was nevertheless entitled to participate because under the plans it was giving up a large measure of voting power and the prospect of future value in the event of inflation and a rise in price levels in later years. In addition, the Second Plan suffered from the same defect as the preregistration plan which had been adversely criticized by the staff in the Summer of 1937. The Third Plan, which had been favorably viewed by the staff, was withdrawn by the management in August 1939 because the decision of the Delaware Court of Chancery in *Havender v. Federal United Corporation*, 6 Atl. (2d) 618, intimated that a Delaware corporation, after recapitalization by merger, could not properly pay dividends on new preferred stock before paying dividend arrears on shares of old preferred which were not surrendered in exchange. The Chancellor's decision thereby cast doubt upon the legality under state law of portions of the Third Plan.

Following the decision of the Supreme Court of Delaware in *Havender v. Federal United Corporation*, 11 Atl. (2d) 331, which reversed the lower court and held that preferred dividend arrears could be eliminated under 4275 Delaware law through a statutory merger, the management filed its Fourth Plan with the Commission on March 30, 1940. This plan proposed a merger of Federal with Operators and Federal Water & Gas Corporation, a wholly-owned subsidiary of Federal.⁹

The Fourth Plan contemplated that the corporation sur-

⁹ Federal Water & Gas Corporation had only a small amount of assets and existed primarily to preserve that corporate name for Federal's use.

viving the merger would issue common stock to the preferred and Class A stockholders of Federal and with no participation being accorded to the Class B stock. The preferred was to receive approximately 90.70% of the new common stock and the Class A, 5.38%. Operators, which owned debentures, a small amount of other assets and several thousand shares of Federal's preferred stock (acquired prior to November 8, 1937) as well as all the Class B stock, was to receive 3.92% of the new common stock in exchange for its preferred stock holdings, debentures and miscellaneous assets.

The plan retained a provision of the Third Plan for election of the directors for staggered terms of office. This provision was included, as Chenery testified, in order to give "consideration, slight though it be, if any, to the B stockholders. The B at the moment was 43% voting power in this corporation and it is in this plan consenting to be wiped out without one cent being paid to it." Our staff had indicated its approval of this provision, while the Commission had not committed itself one way or the other.

V. The Purchase of Federal's Preferred Stock by the Management

In connection with the First Plan, Federal's management filed a statement of all purchases and sales made between October 20, 1934, and November 8, 1937, of securities of Federal, Operators; and all subsidiaries of Federal in which any officer or director of Federal or any of their principal advisers in connection with the plan had a beneficial interest. From this it appeared, and it was later developed at the hearing, that ██████████ Chenery and Chenery Corporation had acquired 2,164 shares of Federal's preferred stock before the filing of the first plan, of which about 600 shares had been purchased between October 19 and 29, 1937, immediately prior to the public announcement of the plan. These later purchases were criticized by a stockholder who participated in the hearing and it appears that shortly

thereafter at a meeting of Federal's management it was agreed not to purchase any stock while negotiations for a plan of reorganization were pending and the terms of the plan were undisclosed to investors. Subsequently the interveners acquired additional shares in the open market, at various times deemed by them to be permissible during the pendency of the proceeding. Reports of purchases were filed with this Commission as required by Section 17 (a) of the Act.

4276 In summary, between November 8, 1937, when the First Plan was filed, and June 30, 1940, when purchases ceased, C. T. Chenery and Chenery Corporation purchased 8,618 shares of Federal's preferred stock and other officers and directors purchased 3,789 shares. All this stock had been acquired through brokers in the open market with the exception of a block of 2,700 shares which Chenery had obtained from a securities dealer on June 10, 1940, in exchange for \$100,000 principal amount of Federal's debentures. The market purchases were made at prices ranging from $16\frac{1}{2}$ to $35\frac{1}{2}$ for the \$6 preferred, $18\frac{1}{2}$ to $36\frac{1}{2}$ for the \$6.50 preferred, and 18 to $36\frac{1}{2}$ for the \$7 preferred. A few of the shares were bought at prices above 30 and a substantial portion at prices in the middle 20's. The foregoing are the shares that are in controversy in this case.

At the hearing on the Fourth Plan Chenery testified on cross-examination that "there is no secret about the fact that I have bought preferred stock and have advised others to buy preferred stock."

Under the Fourth Plan, as originally proposed, the preferred shares which Chenery and Chenery Corporation had acquired during the course of the reorganization at an aggregate cost of \$240,148 would be exchanged for new common stock with a book value of \$803,972, and the preferred stock acquired by the other officers and directors at an aggregate cost of \$88,199 would be exchanged for new

common with a book value of \$358,459.¹⁰ Such common stock would have represented a 7.4% of the total voting power. Adding the 2.7% of voting power represented by the new common which the management was to receive for their preferred stock acquired prior to the filing of the First Plan, and for their approximately one-third interest in the 6,500 preferred shares previously acquired by Operators, the management stood to hold 10.1% of the total voting power in the reorganized corporation. Ten percent or more of voting power is made by this Act presumptive of control. (Sections 2 (a) (7), 2 (a) (8)).

4277 VI. *The Commission's Tentative Conclusions About the Management's Preferred Stock Purchases*

On June 29, 1940, the Commission (Commissioners Healy and Henderson not participating) issued its tentative findings and opinion on the Fourth Plan and indicated therein that the plan was unfair and inequitable and in violation of the standards of Section 7 of the Act because of the provision (which had been included at the suggestion of an officer of our staff) for the election of directors for staggered terms of office. The Commission also considered the purchases of preferred shares by the management during the pendency of the reorganization, at the depressed market prices then prevailing, and pointed out that it might be necessary to consider whether the shares so acquired should be admitted to participation on the same basis as that accorded other preferred shares. The tentative opinion ob-

¹⁰ It should be noted that these book figures, aggregating about \$1,162,000, were substantially more than the Commission's estimates of what the new common stock could be sold for initially in the market. Under the Fourth Plan as originally filed the new common stock was assigned a par value of \$12 per share, a figure which the Commission considered far out of line with corporate earnings and probable market price. When the Fourth Plan was finally approved it was upon the basis of a reduced par value of \$5 per share pursuant to an amendment designed to bring the par value in line with the probable market value of the new stock. On this basis the management stood to receive for the preferred stock which they had acquired during the reorganization 79,077 shares of new common stock having a par value and probable market value of approximately \$5 per share or an aggregate of \$395,385, as compared with the aggregate cost of \$328,347 for the preferred shares.

served that "the discretion and judgment of the management is, as a practical matter, largely determinative not only of what kind of a plan of voluntary reorganization shall be proposed but of when it shall be proposed."

VII. *Contemporaneous Adjustments of Subsidiaries*

During the period that this reorganization proceeding was pending before us, we had occasion to consider various financial problems of the subsidiaries. Thus Southern Natural Gas Co., which had shortly before gone through reorganization under Section 77B, undertook to refund its debt, recapitalize its stock interests and sell new securities (see *Southern Natural Gas Co.*, 4 S.E.C. 653, 779, 1022; 6 S.E.C. 115; 8 S.E.C. 432; 9 S.E.C. 486), and acquire additional gas transmission facilities (*Southern Natural Gas Co.*, 3 S.E.C. 264).

Alabama Water Service Company, another subsidiary, likewise carried out a refinancing program (*Alabama Gas Co.*, 2 S.E.C. 852; *Alabama Water Service Co.*, 8 S.E.C. 92).

In this period Federal acquired the stock and debt of Chattanooga Gas Company from United Light and Power Company (*United Light and Power Co.*, 6 S.E.C. 670) and thereafter carried out an accounting reorganization of that company (*Federal Water Service Corp.*, 7 S.E.C. 785).

Early in the proceeding Federal undertook to increase its ownership of West Virginia Water Service Company by acquiring the preferred stock of the subsidiary from a bank (*Federal Water Service Corp.*, 3 S.E.C. 369).

Finally, at the time we issued our opinion and order of March 24, 1941, there was pending before us a proposal by Federal and certain of its subsidiaries by which certain Pennsylvania water properties of Federal's subsidiaries would be sold to a local public authority to be formed, and the gas properties then held by those companies would be vested in one of the subsidiaries under a simplified capital structure. (*Federal Water Service Corp.*, 8 S.E.C. at 906).

4278 Certain of these rearrangements necessarily affected our consideration and determination as to the fairness of Federal plan. See, *e. g.*, 8 S.E.C. at 905-906.

We cite these adjustments, each of which received our approval, to illustrate the complexity of the background of the plans under consideration and to indicate the far-reaching functions of the holding company management during the reorganization period.

VIII. *Testimony as to the Management's Reasons for Purchasing the Preferred Stock*

Thereafter the hearing reconvened, and C. T. Chenery testified further about the management's preferred stock acquisition program. He stated:

"Chenery Corporation purchased it on my advice. I have felt, have testified, and have told everyone who has asked me over the past years that I thought that preferred stock of Federal Water Service Corporation, over a long period of time, was sufficiently sound so that it would again pay dividends and that this would be true whether any plan of reclassification was consummated or not, that there were inherent values in the Corporation which would be reflected in the stock and that if no plan of reclassification were put through, that the accumulation of the earnings over a period of time would be sufficient to cure the deficit and dividends would again be resumed.

"Also, the officers and employees of this Corporation bought the B stock in 1932 at my suggestion and on my advice and paid approximately \$600,000 for it, contracted to pay more. The situation of the Corporation since that time has improved substantially. This B stock was bought by all classes of employees. I think more than 99 percent of officers and employees bought it and paid for it by deductions from their salaries over a three or four-year period.

"The original plans for reclassification contemplated that the B stockholders would be given an opportunity to

buy their way back in the Corporation, first by giving them a special stock which was convertible into new common stock upon the payment of cash and which maintained their voting power over a period of years; second, by giving them options so that it was all the time contemplated that these people who held this Corporation together by contributions from their salaries and wages should not be thrown out. I have always regarded the ownership of this stock by the employees of the Corporation as one of the great assets of the Corporation.

4279 "Then the view shifted and apparently the feeling was that little consideration should be given to the B stock and finally that none should be given to it. The voting control of the B stock was thrown into the open market for anybody to pick up who desired it. I had knowledge first that the preferred stock was freely traded on the market, that there were any number of investment bankers buying and selling it constantly and secondly, that strong financial interests were accumulating substantial blocks of this stock.

"As long as we thought that a plan would be worked out which would give the B stock an opportunity to come back in the future, my suggestion was to those stockholders and I think I testified to this effect at the first hearing here in 1937 that they should save so that at the expiration or at the end of the period, they would be in a position to exercise the option and acquire that stock. Then when it became apparent that this was not to be, a meeting was held of the B stockholders and it was their decision that they would contest any plan which worked them out completely and the suggestion was made that it would be wise to purchase such preferred stock as they reasonably could so that in the event that there was litigation and the plan was not worked out and that finally it should be held that the B stock was not entitled to anything, that these men who had held this Corporation together and who were its loyal servants would still have some position in the Corporation, some voice.

"It was that consideration, as well as the feeling that the stock itself was inherently worth what was being paid for it, which prompted me to advise Chenery Corporation as well as to advise others who asked me I thought it was wise for them to buy the preferred stock."

At another point Chenery stated that his motive in purchasing the preferred stock "was the combined motive of increasing voting power plus the expectation that it would prove a financially desirable investment . . . I think there is more stress on the voting power than on the investment, however." He added:

"I think it was after we had been advised by the staff in 1938 that the Commission would not approve the plan, the plan then before it, the special stock plan, I thought that we were headed in for litigation with the Commission on the capital reduction plan. I contemplated the possibility that we might lose. I thought we would win, but I thought we might lose, and these officers and employees had bought this B stock on my urging and they had paid for it with deductions from their salary over a three- or four-year period, and I did not want to see a situation in which the control of this company would be thrown in the open
4280 market and anybody with a few hundred thousand dollars can step in and pick it up. I wanted the employees if they lost the B stock to have some secondary line of defense, which I thought would be in the ownership of the preferred stock, and I said it ~~was~~ my view that it was sound policy for every person in the employ of the company who could spare the money to buy such preferred stock as they could carry, and that I would buy all that I could, through the Chenery Corporation.

"Many of them did buy such preferred stock. In some cases groups got together and borrowed money from the bank to be paid over a period of time with which to buy this preferred stock.

"In the case of Chenery Corporation, we liquidated dividend-paying securities at a loss in order to buy this stock.

"The pendency of the plan, the time of the plan, had nothing to do with it. When we could sell this stock and buy up Federal preferred on pre-determined ratios, the orders to the brokers were to sell the other stock and buy Federal preferred."

"Now I take full responsibility for the purchase of stock by officers and employees. I not only thought it was a sound thing for them to do, I thought it was highly desirable, not only from their viewpoint but from the viewpoint of the corporation, and I so expressed that opinion. I also said that I thought that the stock was inherently sound, that over a period of time, whether we had a plan or did not have a plan, that they wouldn't have any loss in the stock."

4281 IX. *The Commission's Decision in 1941*

Following the conclusion of the hearings, we heard argument on the points which we had previously raised with respect to the provision for the staggered election of directors and for according equal participation to the preferred stock acquired by the management during the reorganization.

On March 24, 1941, the Commission issued its findings and opinion concluding that it could not approve the Fourth Plan under the applicable provisions of the Act unless (a) the par value to be assigned to the new common stock were reduced, (b) the provision for election of directors to staggered terms of office were eliminated, and (c) the preferred stock acquired by the management during the period of re-

11 Chenery's testimony that the purchases of preferred stock by Chenery Corporation were not related to the conditions of the plans, was developed further at another point in the hearing where he testified that very early in the proceeding he had given general oral instructions to brokers to liquidate large blocks of other securities held by the Corporation over a long period of time. His instructions were, for example, "that we would sell 'X' shares of Alabama Water Service when we could buy three shares of Federal with the proceeds of the sale of one Alabama." He insisted that he had "no knowledge of when that was bought or sold after the decision was made to liquidate one security and buy this preferred." There was no period in which he thought it would have been improper to give instructions to brokers, "because at the time it was not in connection with any plan but over a long term period and the plan would have little to do with it. I never considered a plan imminent and I don't now consider one imminent."

organization were accorded only a limited participation in accordance with some formula which might afterward be evolved.¹²

The plan was amended to comply with these conditions and provided that approximately 11,000 preferred shares purchased during the course of the reorganization and retained by the present interveners should be surrendered to the surviving corporation for retirement, at cost plus 4% interest from the dates of purchase to the effective date of the merger. With respect to approximately 1,400 preferred shares sold by the management during the course of the reorganization, the amended plan provided for surrender of the profit on such sales less 4% interest on the cost.

C. T. Chenery, acting for himself and as president of Chenery Corporation, and certain other members of the management acting in their own behalf, filed their objections to the treatment accorded the preferred stock which they had purchased during the reorganization. They were permitted to intervene in the proceeding and file briefs on this question. On September 24, 1941, the Commission (Commissioner Healy dissenting, and Commissioner Purcell not participating) issued its supplemental findings, opinion and order approving the Fourth Plan as amended and on November 7, 1941, was notified that the amended plan had been consummated.¹³ There then followed the ap-

¹² Commissioner Healy filed a dissenting opinion, taking the position that the plan was unfair because it accorded participation in the reorganized company to the Federal Class A stock and did not limit participation to the preferred stock. He did not dissent from the conclusion that the management's preferred stock could not be treated on a parity with publicly held preferred stock.

Commissioner Henderson did not participate in the decision.

¹³ The interveners voted their stock against the plan for the purpose of protecting their rights as they might be established in proceedings to review the Commission's order of September 24, 1941. In letters addressed to Federal accompanying their negative proxies, the interveners stated in substance that if in the review proceedings which they proposed to institute it should be finally determined that the Commission's order should be affirmed, they would surrender their preferred shares acquired during the reorganization to the surviving corporation for cancellation at cost plus 4% interest from the dates of purchase to the effective date of the merger. It was further stated that, on the other hand, if it should be finally determined that the Commission's order should be modified, or set aside the interveners would accept stock of the

peals mentioned in the first part of this opinion, culminating in the remand of the case to us.

4282

Questions Presented :

The order set aside by the Court of Appeals was our order of September 24, 1941, approving the amended Fourth Plan which included the provision limiting the interveners to cost plus 4% interest in respect of the preferred shares acquired by them while the reorganization was in process and while they occupied dominant positions in Federal's management.¹⁴ What we are asked now to approve is the same plan amended so as to permit the interveners to exchange those preferred shares for new common stock of the reorganized corporation on the same basis as publicly-held preferred shares.

4283 Thus the precise question is whether, on the record before us, it would be consistent with the purposes and standards of the Holding Company Act for us to approve the amended plan as the means by which the interveners may realize the increment, in terms of profit and control, that they expected would accrue to them through their acquisition of preferred shares while this reorganization was under consideration.

surviving corporation in exchange for their preferred shares in question on the same basis of exchange as was provided in the plan for the public preferred stockholders in satisfaction of any rights which the interveners might have to the value of their preferred shares, presumably, in appraisal proceedings under Delaware law.

¹⁴ The interveners object to being designated as a group as "Federal's management," pointing out that some of the interveners were not officers or directors of Federal (being officers and directors of Operators), while four of the seven directors of Federal were not otherwise connected with Operators. Granting that the interveners did not take action in the management of Federal as a board or formal group, and that some of Federal's management did not participate in preferred stock purchases and are therefore not among the interveners now before us, nevertheless there can be no doubt that the individual interveners occupied dominant positions in Federal's system, directly or through Operators, and had the requisite power among them to control the management and policies of Federal and its subsidiaries at all times under consideration. For the purposes of this proceeding, therefore, they may be regarded as managers of Federal, and are from time to time referred to as Federal's "management."

This question, as we see it, is not the same as the more general legal question whether corporate managers normally are entitled to realize whatever advantages they may seek by trading in the stock of the corporation they manage. Two main factors limit and define the issue before us more narrowly and require that for correct decision it must be considered in sharp focus under the provisions of this particular statute.

The first of these factors is the nature of our function under the Act at this stage of the proceedings. The second is the nature of the voluntary reorganization process established by the Act, wherein the holding company management occupies the position of an active and, as far as the corporation is concerned, the dominating participant.

In passing upon the plan under the Act we must consider three statutory questions in the light of the record before us. These are:

(1) Is the plan with the proposed amendment "fair and equitable" to the persons affected thereby within the meaning of Section 11 (e)?

(2) Are the terms on which it is proposed that the new common stock shall be issued "detrimental to the public interest or the interest of investors or consumers" within the meaning of Section 7 (d) (6) of the Act? and

(3) Will the proposed alteration of rights of Federal's security holders "result in an unfair or inequitable distribution of voting power" among the security holders of Federal or be "detrimental to the public interest or the interest of investors or consumers" within the meaning of Section 7 (e) ?¹⁵

4284 With respect to the first of these questions, if the record leads us to a negative answer, or leaves undisputed doubts generated by any step taken by the man-

¹⁵ These statutory questions run together through every aspect of this case. In large measure they are affected by similar considerations. To treat them separately would create artificial demarcations and would necessitate substantial repetition of facts and reasoning. Accordingly, we shall discuss the case as a whole, pointing out in the course of that discussion what we believe our answers to these questions must be.

agement in the reorganization process, we cannot in good conscience make the affirmative finding required to sustain our approval and must accordingly withhold such approval, even if we made no affirmative finding under the second or third question above.

To answer these questions properly we cannot confine our consideration to the disappointment of the interveners' expectation that would follow from rejection of the proposed amendment. The statute contemplates that we shall consider as a whole the effect, as regards fairness and detriment, which the development and consummation of the plan would have upon all of the persons affected by it if it should be amended as the interveners propose.¹⁶

The characteristics of the reorganization process established by the Act will be discussed in some detail below. It is sufficient to state here that the purchases in controversy in this proceeding were made not while corporate operations were taking their normal course but during a critical period while the corporation and its subsidiaries were undergoing necessary structural changes. The reorganization period differs, we believe significantly, from periods of ordinary, everyday corporate operation; members of the corporate management become also reorganization managers, and thereby, as we shall see, acquire additional powers and functions. We believe they acquire, at the same time, additional duties and responsibilities, as will be more fully developed below.

¹⁶ This is not a situation in which our powers enable us to direct the giving of full affirmative relief to all persons who may have been adversely affected by events connected with the reorganization. Our powers at this stage are limited to approval, disapproval or modification of the plan proposed. But unless we can be firmly and fully satisfied that approval of the plan would not facilitate and confirm the realization of benefits gained through utilization of the managers' especially advantageous position, at the expense of others who have also been participants in the enterprise at any time during the reorganization proceedings, we cannot affirmatively find that the plan is fair and equitable to all the persons affected.

CONCLUSIONS

Ultimate Conclusion

For the reasons stated hereafter, we are unable to find that the plan if amended as proposed would be "fair and equitable to the persons affected thereby" within the meaning of Section 11 (e) of the Act. It is our view that the plan so amended would involve the issuance of securities on terms "detrimental to the public interest and the interest of investors" forbidden by Sections 7 (d) (6) and 7 (e) of the Act, and would result in an unfair and inequitable distribution of voting power within the meaning of the latter section. Thus we are unable to approve the amended plan.

428^b We are led to this result not by proof that the interveners committed acts of conscious wrongdoing but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration.¹⁷ Doubts, inevitably suggested by the existence of these conflicting interests, remain unresolved and prevent an affirmative finding of fairness and equity under Section 11 (e).

The existence of such conflicting interests, and the persistence of unanswered questions they generate similarly furnish the basis for a finding that component elements of the plan, with the proposed amendment, would be "detrimental" within the meaning of Sections 7 (d) (6) and 7 (e).

The considerations leading to our ultimate conclusion are discussed under the following topical headings:

- (a) Our Duties and Powers in Reorganization;
- (b) The Powers of a Holding Company Management under the Act;
- (c) Conflicting Interests Arising from Stock Purchase Program by Management During Reorganization under the Act;

¹⁷ We do not here deal with purchases made by any member of a management incidentally and outside of the reorganization context, or pursuant to an approved plan.

(d) The Necessity for Preventive Measures and the Reasons for the Measure Applied in this Case; and

(e) The Reasons for Action by Order Rather Than by General Rule.

(a) *Our Duties and Powers in Reorganization*

As both the majority and the minority of the Supreme Court in the *Chenery* case agree, there can be no question about our duty and power to take appropriate action to correct reorganization abuses under the Holding Company Act for the protection of public investors. Thus, Mr. Justice Frankfurter, speaking for the majority in this case, held:

"In determining whether to approve the plan of reorganization proposed by Federal's management, the Commission could inquire, under § 7 (d) (6) and (e) of the Act, whether the proposal was 'detrimental to the public interest or the interest of investors or consumers,' and, under § 11 (e), whether it was 'fair and equitable.'" That these provisions were meant to confer upon the Commission broad powers for the protection of the public plainly appears from the reports of the Congressional committees in charge of the legislation. The provisions of § 7 were 'designed to give adequate protection to investors and consumers . . . and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection

4286 against the deleterious practices which have characterized certain holding-company finance in the past."

Sen. Rep. No. 621, 74th Cong. 1st Sess. p. 28. Similarly, the authority given the Commission by § 11 was intended to be responsive to the demands of the particular situations with which the Commission would be faced: 'Under these subsections [11 (d), (e) and (f)], Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities . . .' *Id.*, p. 33.

"... the Commission could take appropriate action for the correction of reorganization abuses found to be 'detrimental to the public interest or the interest of investors or consumers.' It was entitled to take into account those more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Company Act of 1935 was designed to correct. . . ."¹⁸

And Mr. Justice Black, for the minority, declared: "I further agree that Congress conferred on the Commission 'broad powers for the protection of the public', investors and consumers; and that the Commission, not the Court, was invested by Congress with authority to determine whether a proposed reorganization or merger would be 'fair and equitable', or whether it would be 'detrimental to the public interest or the interest of investors or consumers.'"

"The conclusions of the Court with which I disagree are those in which it holds that while the *Securities and Exchange Commission* has abundant power to meet the situation presented by the activities of these respondents, it has not done so." 318 U. S. at 95-96, emphasis supplied.

Our study of corporate reorganizations and our experience with them have brought to our attention many evils that occur in the course of reorganizations effected through management plans without the supervision of any court or regulatory body.¹⁹ In the exercise of our jurisdiction
4287 under Sections 7, 10, 11 (e) and 12 of the Holding Company Act, we have responsibility for passing on

¹⁸ 318 U. S. 90-91, 92; 87 L. Ed. at pp. 834, 835, emphasis supplied.

¹⁹ See our Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (hereinafter referred to as "Protective Committee Study") where we pointed out abuses often found in such plans (Part VII).

The Delaware courts, on the petition of an objecting shareholder, will not upset a plan unless it is "so palpably unfair as to amount to constructive fraud." *Barrett, et al. v. Denver Tramway Corporation*, 53 F. Supp. 198 (D. C. Del., December 3, 1943), and cases cited. See also Dodd, *Fair and Equitable Recapitalizations* (1942), 55 *Harv. L. Rev.* 780.

many management plans, and as an essential element of that responsibility we are obligated to counteract abuses and forestall potential abuses that may be present in those plans.

Congress provided in Section 11 (e) a procedure by which holding companies and their subsidiaries might voluntarily propose and carry out "fair and equitable" plans of reorganization designed to comply with the requirement of the Act. Under that procedure the holding company management—with all its stake in securities, compensation, and other perquisites of both profit and prestige—not only continues in control of the day-to-day business of the system but also determines whether voluntary plans shall be proposed, when they shall be proposed, and what terms and conditions shall be contained in any plans submitted to the Commission. In a Chapter X reorganization such determinations would, of course, be made primarily by an independent trustee who has no pecuniary interest in the securities and whose compensation is subject to the jurisdiction of the court. Instead of that machinery Congress intended that in Section 11 (e) the Commission should have "the complete supervisory power which is essential to the elimination of the present wasteful practices in corporate reorganizations" and that "Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities."²⁰ This intention was apparently in furtherance of the recommendation of the National Power Policy Committee that:

"... it seems administratively advisable that every opportunity be offered the owners of holding company securities to work out their own process of dismantling. That opportunity should, of course, be vigilantly guarded to protect the average investor from the exploitation threatening him

²⁰ S. Rep. No. 621, 74th Cong., 1st Sess. (May 1935), p. 33.

almost as a matter of course under our usual methods and mores of corporate reorganization . . .²¹

(b) *The Powers of a Holding Company Management under the Act*

It has been our experience under the Act that the normal influence of a holding-company management pervades the entire system down to the lowest tier of operating companies. For example, in this case, directly and through control of Operators (the holder of all of Federal's Class B stock), the interveners controlled a utility system of 42 subholding and operating companies which operated water, gas, electric and other properties in 13 states and one foreign country. In this system the interveners occupied over 100 directorships, 35 presidencies, 20 vice presidencies and 6 treasuries; one intervener was chairman of the board of 11 companies, another was general counsel for 17 companies and a third was a consulting engineer for 16 companies. With respect to Federal itself the interveners included three directors, the president, six vice presidents, the secretary and the treasurer.

The management of a holding company under the Act, through its pervasive control over the financial, operational and accounting policies of the parent and its operating subsidiaries, is in a position to initiate and shape market movements. It can determine whether and when subsidiary earnings are to be drawn up into the holding company or withheld or obscured within the accounts of the subsidiaries. Through such determinations it can affect substantially the corporate income of the holding company, reduce or increase an impairment of capital, and ultimately affect its ability to pay dividends. These are important factors affecting the market prices of the holding company's outstanding securities, and even affecting the ultimate allocation

²¹ Appendix to Sen. Rep. No. 621 (74th Cong., 1st Sess.) on S. 2796, at p. 58.

tion of new securities among the various classes of security holders.

Without trespassing beyond the confines of business judgment, the income record, both of the holding company and of the system consolidated, may be vitally affected by managerial decisions. For instance, management exercises business judgment as to whether subsidiaries should plow back earnings for expansion; whether more or less should be charged by them for depreciation (this being affected, in turn, by their decisions as to retirements of property and charges against the reserve); and whether funds needed by the subsidiaries could be obtained through borrowings at interest or through sales of equity securities. Still within the realm of business judgment and of considerable influence upon subsidiary profits is management's control over the day-to-day business and accounting practices of subsidiaries. It has been our experience that earnings may be obscured and used up in the subsidiaries, or allowed to become a part of its net profits, by deviations between stringent and liberal maintenance policies, by varying allocations of expenditures between maintenance expense and capital asset accounts, by the enlargement or depletion of tax, accident and other like reserves, by the recognition or non-recognition of losses, and by charging losses against surplus rather than income, or *vice versa*.

When these powers are taken into account it becomes evident that a management's ultimate decision about whether operating company dividends shall be declared, and when, and in what amounts, is the culmination of a long series of discretionary judgments, many within the range of acceptable accounting and business practices, and all of real concern to the holding company's stockholders. In the pyramided corporate structures with which we daily have to deal, where opportunity for manipulation is multiplied and where slight changes of policy in the underlying companies may make all the difference between a dividend
4289 passed and a dividend paid, the combination of these

basic judgments is of the greatest significance. Statutory regulation by state and federal administrative agencies affects in many ways, but it is not designed to eliminate managerial discretion over such matters.²²

In addition, the management has power to make or refrain from making proposals for refinancing of subsidiaries and the sale and rearrangement of subsidiary properties which often have substantial effects upon the flow of earnings to the holding company.

Additional powers come into the hands of the management of a holding company when it undertakes to prepare and put into effect a plan of reorganization under the provisions of the Act. These are special powers beyond those the management normally exercises in directing the corporation's everyday operations. To an extent that may vary depending upon circumstances, these new powers may introduce conflicts between the interests of the management as the group in control of the corporation's normal operations and its responsibilities to the various classes of the corporation's stockholders, all of whose interests it assumes to represent in performing its functions in connection with the reorganization.

Under Section 11 of the Act, as the Supreme Court noted in this case, officers and directors of a holding company are vested with "broad powers as representatives of all the stockholders."²³ The management initiates the proceeding before the Commission, draws up and files the plan of reorganization, and may file amendments thereto at any time. As far as the corporation is concerned the management controls the timing and duration of the steps taken in the proceedings concerning the reorganization.

In addition, the management of a holding company engaged in a reorganization proceeding under the Act generally has opportunities (certainly more convenient and fre-

²² Compare the powers of a District Judge exercised in a Chapter X proceeding through an independent trustee. These extend far more into the field of business management than any regulatory powers that we possess.

²³ 318 U. S. at 91; 87 L. Ed. at 635.

quent than the opportunities available to the usually scattered public stockholders) to discover through discussion with our staff, and to appraise in advance, the attitude with regard to the terms of pending plans or future proposals which the staff is likely to urge before the Commission. Consultation of this kind is a constructive factor in the development of plans for the consideration of the Commission, provided, of course, that knowledge so acquired is used for the benefit of all participants in the enterprise and not exclusively for the benefit of the management or a relatively small number of persons who may be permitted by the management to share in the special knowledge to which it has ready access.

4290 The combination of these multiple powers in the management while a reorganization is under consideration places at its command a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute. If, in this setting, the management enters upon a stock purchase program there is inevitably the temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices. Public announcements by the management can be directed to that end. Steps can be taken that may delay and protract the proceedings in such a manner as to make senior stockholders lose hope of receiving dividends within a reasonable time and induce some of them to sell out at a sacrifice.²⁴

²⁴ We have observed that many unsupervised reorganizations have been accomplished by first stopping dividends and starving the non-voting preferred stock to the point of desperation, then wielding the voting power of the junior stock as a weapon to force ultimate reorganization on terms unduly favorable to the latter. The management of a holding company is in a peculiarly strategic position to know the meaning of the non-payment of dividends, and what can be done to remove blocks in the flow of earnings from subsidiaries.

(c) *Conflicting Interests Arising from Stock Purchase Program by Management During Reorganization under the Act.*

We have had occasion to note previously the conflict often existing between corporate management and one or more classes of security holders because of management's predominant representation of the interests of one class, usually the junior class, by which it is elected to office and in which it often has a financial interest.²³ While such a conflict may be present in every reorganization in which the plan is not formulated by an independent trustee or other disinterested agency, and not infrequently has its effect on the management's actions with respect to the formulation and negotiation of plans of reorganization, those factors are normal and unavoidable attributes of extra-judicial reorganizations, and may be anticipated accordingly.

4291 When, however, members of a management determine to obtain personal advantage out of a reorganization by engaging in a program of buying outstanding securities, for the purpose of realizing either the voting power or the enhanced value they expect those securities to have in the reorganized corporation, or both, the conflict is no longer either normal or unavoidable. The managers then have undertaken to act affirmatively in their own interests, with reference to the reorganization, and anything they gain therefrom must necessarily be at the expense of persons whom they are under a duty to represent. At that

Cf. Our observations with respect to trading by committee members, Protective Committee Study, Part VIII, p. 440:

"Similarly by incomplete disclosure of information a committee can shade the apparent significance of such information [about the status of the company or contemplated changes in its operations], and reserve for themselves the benefits of trading on the basis of actual significance of events."

²³ Protective Committee Study, Part VII, pp. 11-13. See also, Protective Committee Study, Part II, pp. 8-10; Part VIII, pp. 106-13, 311. We observed the same conflicts of interest in our Report on Investment Trusts and Investment Companies, Part Three, Ch. IV, pp. 1410-1523.

point, any management, no matter how honorable, makes its own motives suspect. Indeed, once it enters upon such a program even its acts prior to reorganization are compromised in retrospect because for all practical purposes it is impossible for anyone, attempting at a later time to trace back and sort out the motives that guided such action, to reach a firm conclusion that managerial judgment was not in at least some respects exercised in contemplation of the personal gain to be realized ultimately from the reorganization.

It is our view that no management of a holding company can engage in a program of buying its company's stock during the course of a reorganization under the Act, without raising the probability that in one way or another the personal interests it seeks to further through its program will be opposed to its duties to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously. The natural inclination of any person to buy cheaply, coupled with the normal and extraordinary powers of a holding-company management to further that objective by creating the conditions which make cheap buying possible during the course of a reorganization before us, are bound to create a risk—perhaps in some cases merely potential but in all cases very real—of harm to all of the company's public-security holders whether or not they elect to sell. In such a case the managers are not buying merely against future market risks. They are buying against a reorganization which they themselves are planning, during a period in which they exercise, as far as the corporation is concerned, a dominant influence over most of the factors that affect the progress and outcome of the reorganization, including not only the daily operations of the system companies but also, to a very large extent, the timing of steps to be taken on behalf of the reorganiz-

ing company and public statements concerning the entire enterprise.²⁶

4292 If in any case we had proof that reorganization managers had actually purchased future control at bargain prices intentionally created or maintained by their own acts, plainly we would be unable to find fair and equitable a plan of reorganization which embodied provisions allowing them to reap the benefits.

But even where proof of intentional wrongdoing is lacking, should the answer be substantially different? We think not. Where the management embarks upon a stock purchase program during a reorganization, it places its personal interests actively at odds with the interests of other stockholders it represents in the reorganization. Where that occurs, and the management thereafter submits a plan by which it would realize substantial benefits through stock acquired during its purchase program, it asks us to make what in effect is a positive finding that its realization of such benefits is fair and equitable to all persons affected by the plan. In such circumstances we do not believe the statute limits our power and duty to withhold approval solely to cases in which someone is able to establish by affirmative evidence that actual misconduct accompanied such a conflict of interests. It is the responsibility of the proponents of the plan to satisfy us that the plan is fair and equitable under Section 11(e). An affirmative determination of that kind cannot appropriately be left to rest upon conjecture.

Questions as to whether fiduciaries have taken advantage of a position of conflicting interest in which they have

²⁶ Perhaps the significance of such a situation would be more readily evident if the managers conferred personally with stockholders, assuming the role of arms-length bargainers for the purchase of stock across the table. The difference between that and buying on the open market creates no significant distinction in favor of the managers, however, if they are in a position to shape the pattern of the whole market. Indeed, where the whole market is affected any harm done is that much more widespread. But in either case, the primary point of our present problem is not the fairness of specific transactions across the table or in the market, but what harmful effects the market interest of the managers may have upon the reorganization and the entire body of security holders represented by the managers.

placed themselves are not lightly to be resolved in favor of the fiduciaries.²⁷ Where the managers have created a conflict of the kind disclosed by this record we do not believe that by merely submitting a plan, they cast upon us the onerous function of searching out each of their many acts that might be pertinent to the plan's fairness, considering the relationship between each act that seems significant and a dozen others, and weighing the chances whether acts subject to two or more inferences have or have not been detrimental to investors affected by the plan.

4293 Our primary concern must be with the basic problems involved in appraising the fairness of plans of reorganization as they affect investors, the feasibility of such plans, and the extent to which they effectuate the objectives of the Act. Inevitably, it would greatly protract hearings under the Act if it were necessary to divert our processes for the purpose of exploring, as a side issue, the notices that activate each step taken by reorganization managers when they set out to acquire securities of the company in reorganization. Such delay in itself would be detrimental to the interests of those investors who have a right to expect fair and expeditious reorganization. Moreover, the exploration would almost inevitably be a fruitless

²⁷ Passing judgment on the personal integrity and will-power of the individual fiduciary in particular cases, where conflicts of interest are shown to exist, is a function that is traditionally avoided by courts of equity.

It is significant that so great a chancellor as Lord Eldon placed the rule permitting a cestui que trust to set aside his trustee's self-dealings, whether or not the trustee had profited, upon the ground that:

"... though you may see in a particular case, that he has not made advantage, it is utterly impossible to examine upon satisfactory evidence in the power of the Court, by which I mean, in the power of the parties, in ninety nine cases out of an hundred, whether he has made advantage, or not. Suppose, a trustee buys any estate; and by the knowledge acquired, in that character discovers a valuable coal-mine under it; and looking that up in his own breast enters into a contract with the Cestui que trust; if he chooses to deny it, how can the Court try that against that denial? The probability is, that a trustee, who has once conceived such a purpose will never disclose it; and the Cestui que trust will be effectually defrauded.

* * * * *

Unless the policy of the Law makes it impossible for them to do any thing for their own benefit, it is impossible to see, in what cases the transaction is morally right." Ex parte Lacey, 6 Vesey 625, 626a, 628 (1802).

effort to discover the workings of the minds of those managers who ask us to confirm to them the personal advantages they sought to gain through a combination of the purchase program and the reorganization.

The plain fact is that an absence of unfairness or detriment in cases of this sort would be practically impossible to establish by proof. Evidence of good faith in the running of the corporation and in the conduct of the reorganization boils down largely to post hoc disputes over managerial discretion and judgment. Subtle influences over these affairs may not have been detected by the managers themselves, in searching their own minds; a shortage of vision can often be created by personal interest, and without any consciousness of guilt. Questionable transactions may be explained away, and an abuse of investors and the administrative process may be perpetrated without evil intent, yet the injury will remain.

In this connection it should be noted that even if we could measure the injury which may have resulted to individual investors, it could not be specifically remedied under the Act. And as a practical matter, even if we had the power, we could not hope to restore losses caused by delay, manipulation of accounts, timing of financing, withholding of dividends and other devices a management might use to facilitate purchasing.

4294 Turning now to the case before us the salient fact is, as the interveners have stated, that their primary object in buying the preferred stock of Federal was to obtain the voting power that was accruing to that stock through the reorganization, and to profit from their investment therein. This stock they had purchased in the market at prices that were depressed in relation to what they anticipated would be, and what in fact was, the earning and asset value of its reorganization equivalent. We think we need look no further than this.

We have given detailed consideration to inferences which might be drawn unfavorably to the interveners from

various acts and declarations of Federal's management prior to and during the course of this reorganization. The interveners, upon the reargument, objected to those inferences as unfairly impugning their motives, and put forward other possible, and innocent, inferences which might be drawn from those same acts and statements. We deem it unnecessary to make a point of how these interveners, if they had been so disposed, could have benefited themselves in dealing with specific problems which arose in this reorganization. We have already indicated the possibilities in general terms, and will state here only the interveners' interpretation of their conduct of the reorganization.

They state that their efforts to formulate a plan of reorganization both before and after registration were designed to benefit the preferred and Class A stockholders by curing the capital impairment and thereby releasing current earnings for the payment of dividends, and that the various plans which they proposed represented increasing concessions by the Class B stock which, although worthless from an asset and earnings point of view, they honestly believed to have a prospect of future value in the event of inflation. They contend that Federal could not have drawn up from its subsidiaries any additional income during the years 1932 to 1937 because the subsidiaries themselves had preferred dividend arrearages which prevented the payment of dividends on the common stocks held by Federal. They point out that the first and third plans which were proposed after Federal had registered had been the subject of favorable comments from our staff, and argue that changing viewpoints within the Commission, rather than any acts on their part, were responsible for the delays in the reorganization proceeding. They have assured us that they did not purchase stock while they had information about plans which was not known to the public, and urge that they honestly thought, at the time they purchased the preferred stock, that it did not jeopardize the interests of security holders but was, on the contrary, beneficial to the

company and its investors for them to do so. In short, they say with evident sincerity that they bought the stock honestly, with full disclosure, at a fair price and without any harmful effects upon the plan and the interests of investors. Thus their defense is to deny that they made selfish use of their powers during the period when their conflict of interest, vis-a-vis public investors, was in existence owing to their purchase program.

4295 As we have already indicated, the personal integrity of these particular interveners is not a question at issue in this case. For obvious reasons we do not conceive it our function to try to guess whether a reorganization manager, faced with a choice of conducting the reorganization for the accomplishment of his own objectives or for the benefit of security holders generally, is the kind of man who would be likely to take one course and not the other. What we say is that when reorganization managers have undertaken a program of acquiring their company's securities for their own account, in contemplation of or during the reorganization proceedings under their charge, they have placed themselves in a position where they are peculiarly susceptible to temptation to conduct the reorganization for personal gain rather than the public good; the program of making advantageous purchases of stock could have had an important influence—even though subconsciously—upon great numbers of business decisions all along the way.

Bearing in mind these functions of reorganization managers and the great complexity of the underlying financial structure that vitally affects the reorganization of any holding company controlling a large utility system, we do not conceive it possible as a practical matter for the reorganization managers to impart to stock holders generally enough of the necessarily superior knowledge they acquire as managers to enable a stockholder to form an independent judgment on the question whether or not he should sell, and at what price.

What we mean, therefore—and we cannot emphasize this too strongly—is that concepts of “honesty, full disclosure and purchase at a fair price,” traditionally applied to dealings in normal course between corporate managers and stockholders, cannot be the controlling tests in the decision of this case.²⁸ However relevant those concepts might be to issues in civil litigation between an officer or director and the selling stockholder, they are not determinative of our problem, which is to be fully satisfied that the plan of reorganization is fair and equitable, and not detrimental in the particular circumstances bearing upon the acquired stock vis-a-vis the stock of public investors.

4296 In this context we must bear in mind that the conditions that gave rise to the Holding Company Act require us, as the Supreme Court observed in its opinion, to give investors and consumers full protection against “deleterious practices” which are often perceivable solely in the form of “subtle factors” and which too frequently cannot be proven except by the admissions of those whose conduct occasions the inquiry. Since the more subtle, though powerful, forms of such conduct defy specific proof, and since the application of a subjective standard of good faith would in any event be inappropriate here, we must foreclose an inquiry into the motives and intentions of reorganization managers who have engaged in so potentially harmful a practice as seeking to profit by a program of security purchases during the course of a reorganization in which they take so important a role.

²⁸ The Supreme Court read our former opinion in this case as containing a determination by us that “in [our] own words, ‘honesty, full disclosure and purchase at a fair price’ characterized the transactions” (318 U. S. at p. 86; 87 L. Ed. at p. 632). Our counsel, in briefs and arguments upon appeal, also assumed this for the purpose of argument. However, we made no finding to this effect, but said only that “honesty, full disclosure and purchase at a fair price do not take the case outside the rule.” 318 U. S. at p. 87, 87 L. Ed. at p. 632; 8 S. E. C. at pp. 916-17. We said this in the course of stating that equity precedents forbid a trustee to trade for profit even at a fair price and without fraud at a public sale. We meant merely to indicate that what we deemed to be the inflexible rule of equity did not even permit inquiry into the question whether the transactions of the reorganization managers in this case were marked by “honesty, full disclosure and purchase at a fair price.” Cf. Footnote 27, *supra*.

(d) *The Necessity for Preventive Measures and the Reasons for the Measure Applied in this Case.*

The problem before us is, therefore, one of temptations combined with powers of accomplishment. Since the achieving of personal gain through the use of fiduciary power is unfair, we believe the incentive to misuse such power must be removed so that the potentialities of harm to investors and the public will to that extent be eliminated. For the reasons we have already given, we deem it impossible to do less.

A plan of reorganization that would reward the interveners for the very acts that gave rise to a potentially harmful conflict of interest is not prima facie fair and equitable. It would yield to them those very profits, both financially and in terms of voting power, which we think must be denied to them under the Act. Such profits would necessarily be realized at the expense of the public stockholders, both those who sold out and those who held their shares.

Those who sold out cannot be helped in these proceedings. Despite that fact, they are persons who have been affected by the development and consummation of this plan. If there were affirmative proof that the managers intentionally had taken advantage of them, we would be unable to approve as fair and equitable, or as not detrimental to investors, a plan that would confirm to the managers all benefits of the transactions by which they did so. But, even lacking such proof, in the face of the conflict of interest disclosed by this record, we cannot, for the reasons we have described, achieve the positive conviction of fairness to them that we deem essential if the integrity of the reorganization process under this Act is to be maintained above reasonable suspicion.

As to the public stockholders who remain, we cannot make the affirmative finding required by Section 11(e) that the plan is "fair and equitable to the persons affected

thereby" in the face of so many questions about fairness and equity which we believe no amount of testifying can completely and satisfactorily answer. Further, were we to approve a plan so questionable we would be authorizing the issuance of securities to the public and to the 4297 interveners on terms which would give the interveners a premium for risking the interests of the public investors, to the detriment of the latter and, as well, to the detriment of investors in many other holding company securities, and of the public interest, within the meaning of Sections 7 (d) (6) and 7 (e).

(e) *Reasons for Action by Order Rather
Than by General Rule*

We have already pointed out the reasons why it is necessary to act by order in this case, under Sections 11 (e) and 7.

The position of the interveners comes down to this: that approving a plan limiting them to their cost plus 4% interest is unfair to them because when they made their purchases they expected to perpetuate their control and make a profit, and that our order operates, according to their claim, retroactively to prevent the realization of their expectations. But this is true only in the sense that the decision of any case of first impression may have an effect not foreseen or foreseeable. The effects of our decision upon the expectations of the interveners must be weighed against the interests of others, and we think that a contrary decision would be unfair and detrimental to the interests of investors and to the public interest itself.

Moreover in this case the interveners, when they bought the preferred stock of Federal, were not acting wholly in a legal vacuum. As reasonable men they must at least have known that they were running some risk that their purchase program might not achieve its purpose. In fact, at the outset of this proceeding they took steps to avoid the

criticism that had been voiced at the hearings with respect to their early purchases of preferred stock, by agreeing among themselves not to make purchases while negotiations for a plan were pending and the terms of such plan were undisclosed to the public. Moreover, in 1934 the reorganization provisions of the Bankruptcy Act had notified reorganization managers in proceedings under that Act that claims asserted by them in respect of the debtor's securities might be limited to the actual consideration paid

therefor,²⁹ and in 1938 this provision of the Bankruptcy Act was reenacted and broadened.³⁰ While

none of these legal principles was directly applicable to the interveners, they indicated a climate of opinion in which at least some reasonable men considered transactions of this character to be fraught with temptation and of dubious propriety.

The interveners urge that we have no alternative but to act first by general rule or published statement of policy if we are to act at all in a matter of this kind. The Supreme Court indicated the advisability of promulgating a general rule, though we do not understand its opinion to hold that the absence of a pre-existing rule is fatal to the decision we have reached. Now that we have had the question

²⁹ Section 77B (b) of the Bankruptcy Act in part provided:

"... the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor." (Emphasis added.)

³⁰ Section 242 of Chapter X provides:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust; or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair, or not consistent with public policy and may limit any claims or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor." (Emphasis added.)

sharply focused in this and other cases before us, and have had an extensive period in which to consider the problems involved, we may well decide that a general rule, with adequately flexible provisions,³¹ would be both practicable and desirable; but we do not see how the promulgation of such a rule now or later would affect our duty to act in order in this case in deciding whether this plan is fair and equitable and meets the other standards of the Act. We therefore reserve for further consideration the question whether or not a rule should be adopted.

4299 Nature of Order to be Entered

Our order of September 24, 1941, approved Federal's plan as a whole, including the provision for allowing cost plus 4% interest for the preferred shares acquired by the interveners during the course of the reorganization proceeding. Only that provision of our order was objected to upon judicial review under Section 24 (a) of the Act, but the mandate of the Court of Appeals for the District of Columbia appears on its face to set aside our order as a whole. Both we and counsel for Federal Water believe the mandate of the Court of Appeals probably operates so as to set aside only that part of our order which dealt with the interveners' participations under the plan. Counsel for Federal Water has, however, expressed some concern that this mandate might be construed more broadly, and that there may now be no effective order approving the

³¹ Without flexibility the rule might itself operate unfairly. Limitation to cost appears appropriate here, but would be inappropriate in a case where the cost of the security purchased was in excess of its reorganization value, and in some instances cash payment by the company would not be feasible. In addition, special treatment of any sort might be inappropriate for incidental purchases not made as part of a program in contemplation of reorganization benefits. In this connection, we wish to emphasize that our concern here is not primarily with the normal corporate powers which make it possible for officers and directors to influence the market for their own gain, in the absence of reorganization, by a choice of dividend policies, accounting practices, published reports, and the like. The questions of fairness and detriment here presented arise before us in the context of a capital readjustment. At that point our scrutiny is called for, and that our scrutiny is to be vigilant cannot be doubted. See Appendix to Sen. Rep. No. 621 (74th Cong., 1st Sess.) on S. 2796, at p. 58, quoted *supra*.

transactions heretofore effected by the company under the plan. Therefore, although we think the provisions of Section 20 (d) of the Act would go far to protect the company from liability for any acts done in reliance upon our order prior to the Court's mandate, we have determined to eliminate all doubt on this score by treating the pending application as requesting not only an order approving the amendment offered for the benefit of the interveners but also an order approving the other provisions of the plan and the transactions which have already been carried out thereunder.

An appropriate order will issue disapproving the pending amendment and reapproving the plan as constituted on September 24, 1941.

By the Commission (Chairman Purcell and Commissioners Healy, Pike, and McConnaughey).

ORVAL L. DU BOIS

(Seal)

Secretary.

4300 Order Denying Application and Reapproving Plan

Federal Water and Gas Corporation having filed an application for the Commission's approval of an amendment to a plan of reorganization of the applicant's predecessor, Federal Water Service Corporation, under the Public Utility Holding Company Act of 1935:

The Commission having, by order dated September 24, 1941 (Holding Company Act Release No. 3023), approved the plan of Federal Water Service Corporation as constituted on that date, and having been informed that the transactions contemplated by said plan have been consummated except for certain transactions which are the subject matter of the present application;

A question having been raised by the applicant as to whether the effect of the mandate of the Court of Appeals for the District of Columbia was to set aside in its entirety

the Commission's said order of September 24, 1941, and if so, whether the Commission should not reapprove the plan to the extent that it has already been carried out, in addition to approving the pending amendment;

Hearings having been held after appropriate notice, and the Commission being duly advised and having this day issued its findings and opinion herein;

On the basis of said findings and opinion, and pursuant to the provisions of Sections 7 (d) (6), 7 (e) and 11 (e) of said Act, it is

Ordered that the application to amend said plan of reorganization be and hereby is denied; ♥

Further Ordered that the plan of reorganization heretofore approved by the Commission's order of September 24, 1941, and the transactions contemplated by said plan, be and hereby are reapproved, as of September 24, 1941, as more particularly set forth in said order.

By the Commission.

ORVAL E. DU BOIS

Secretary.

(Seal)

Tuesday, November 20th, A. D. 1945

Before Honorable D. LAWRENCE GRONER, Chief Justice, BEN-
NETT CHAMP CLARK, and WILBUR K. MILLER, Associate Justices.

No. 8977—October Term, 1945

CHENERY CORPORATION ET AL., PETITIONERS

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 8978—October Term, 1945

FEDERAL WATER AND GAS CORPORATION, PETITIONER

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

Argument commenced by Mr. Spencer Gordon, attorney for
petitioners in No. 8977, continued by Messrs. Allen S. Hubbard,
attorney for petitioner in No. 8978 and Roger S. Foster, attorney
for respondent, and concluded by Mr. Spencer Gordon.

United States Court of Appeals, District of Columbia

Nos. 8977-8978

No. 8977

CHENERY CORPORATION, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 8978

FEDERAL WATER AND GAS CORPORATION, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petition for Review of Order of Securities and Exchange
Commission

Argued November 20, 1945—Decided February 4, 1946

Mr. Spencer Gordon, with whom Mrs. Virginia Collins Dun-
combe was on the brief, for petitioners in No. 8977.

Mr. Allen S. Hubbard for petitioner in No. 8978.

Mr. Roger S. Foster, Solicitor, Securities and Exchange Commission, for respondent.

Before GRONER, C. J., and CLARK and WILBUR K. MILLER, JJ.

GRONER, C. J.: This is a petition for the review of an order of the Securities and Exchange Commission, issued February 7, 1945, under the Public Utility Holding Company Act. The same case was here in 1942.

A brief statement of proceedings on the first appeal may be helpful in understanding the question now presented for decision.

In 1937 Federal Water Service Corporation, hereafter called "Federal," a Delaware holding company, owning securities of subsidiaries operating water, gas, electric and other properties, filed a plan of voluntary reorganization with the Commission under §§ 7 and 11 of the Holding Company Act of 1935.¹ The plan contemplated simplification of the corporate structure and the elimination of existing capital deficits by a reduction of capital which would permit Federal to resume payment of dividends. Subsequently, two additional plans were filed, but were ultimately withdrawn largely on objection by the Commission's staff.

In March 1940, Federal, as the result of a then recent Delaware Supreme Court decision, filed a new plan of merger, which, with modifications, was approved by the Commission. The new plan, as modified, contained no provision for participation by Class B stock of Federal—which the Commission had found to be without value. Instead, that stock was to be surrendered for cancellation and only Class A common and all issues of preferred were to be converted into common stock of the new corporation.

Petitioners, who were officers and directors of Federal, held a one-third interest in Utility Operators Company, and that company in turn had virtual control of Federal through the ownership of Federal Class B common stock, representing forty-three per cent of voting power. During the period the various plans of reorganization were before the Commission, petitioners purchased Federal's preferred stock to the total amount of 12,467 shares. The purchases were made in the open market, at current prices, from time to time over the three and a half year period during which the negotiations with the Commission's staff were in progress. All of the purchases were made individually, and, except as to Chenery and van den Berg, averaged around 130 shares per individual. Chenery, for the account of a family corporation controlled by him, acquired approximately 8,000 shares, 2,700 shares of which he obtained for \$100,000 of Federal's gold bonds in an exchange arrangement with a banking syndicate; and van

den Berg, who at the time of final action by the Commission had ceased to be a director of the corporation, purchased in the open market approximately 1,700 shares. If the stock so acquired had been converted into common stock of the new corporation, under the plan as finally approved by the Commission, petitioners stood to receive 79,077 shares of new common, having a par and probable market value (as determined by the Commission) of \$5.00 per share, or an aggregate value of \$395,385, in return for the preferred stock which cost petitioners \$328,347, a difference of little more than the amount of interest lost in holding the preferred shares pending completion of the plan. The common stock which petitioners (including Chenery Corporation and van den Berg) would thus have received, if their preferred stock had participated in the new corporation, would have represented 7.4% of the total voting power in the new corporation. In addition, petitioners, individually, had acquired 6,500 preferred shares of Federal prior to the filing of any plan of reorganization which when converted would have represented 2.7% of the total voting power. Added together, petitioners stood to hold 10.1% of the voting power of the reorganized corporation.

The Commission on March 24, 1941, made formal findings on the basis of which it concluded that the plan could not be approved insofar as it provided participation of the preferred shares purchased by petitioners during the period reorganization plans were before the Commission, even though the purchases were made honestly, after full disclosure and at a fair price at public sale. The Commission based its conclusion on its holding that during the pendency of proceedings before the Commission, officers and directors of the corporation occupied a fiduciary relationship to the corporation and to its shareholders, and consequently were subject to the limitations imposed upon fiduciaries in dealing with trust property. Accordingly, on July 1, 1941, an amendment to the plan was submitted by Federal, over petitioners' protest, whereby the stock so purchased would not be converted into common stock of the new corporation, but would be surrendered to the corporation at cost plus 4% interest.

The plan as amended was approved September 24, 1941.

On petition to us to review, we reversed and remanded for further proceedings in conformity with our opinion (*Chenery Corp. v. Securities and Exchange Commission*, 75 U. S. App. D. C. 374, 128 F. 2d 303). Certiorari was granted and on February 1, 1943, the Supreme Court handed down an opinion directing us to remand to the Commission for further action not inconsistent therewith (*Securities and Exchange Commission v. Chenery Corp.*, 318 U. S. 80). On rehearing no new or additional evi-

dence was adduced and in February 1945, the Commission reaffirmed its former order.

The case is now again before us pursuant to § 24 (a) of the Act.

It should be borne in mind that on the previous appeal the Commission conceded that the transactions of which we have spoken were accomplished without ulterior purpose and without intent on petitioners' part to profit personally in the consummation of the plan, likewise held that honesty, full disclosure and purchase at a fair price at public sale characterized the transactions, and concluded that the result was neither unfair nor inequitable to the persons affected by the plan.

Accordingly, we had then, as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless, to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives.

The Supreme Court subsequently held, as we had held, that the Commission's order on this record could not be sustained, but presumably, in order that the Commission might reconsider the case, in the light of the standards imposed by the Act, directed us to remand the cause to the Commission for further proceedings not inconsistent with its opinion. This action is in line with the Supreme Court's statement in the Pottsville case,² that an administrative determination open to judicial review does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy. Considered in this view, obviously, the only question now open is whether the Commission has rightly construed and rightly followed the opinion of the Supreme Court. That the Supreme Court can itself best answer this question goes without saying; but in the meantime it is our duty—which we may not escape by certification—to make, in the light of its content, our own interpretation of the opinion. As preliminary to this, it seems to us clear that the Supreme Court's rejection of the Commission's original order was primarily because it was not sustainable on the grounds on which the Commission based its action—that is to say, the Commission having affirmatively found that petitioners' purchases of stock were in all respects fair, honest and aboveboard, resulting neither in unjust enrichment to themselves, nor harm to other stockholders or the public, such purchases were not subject to proscription on any

² Federal Communications Commission v. Pottsville Broadcasting Co., 309 U. S. 134, 145.

ground relied upon by the Commission. And, as sustaining this, the Supreme Court said:

"Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11 (e), promulgated new general standards of conduct."

The Commission, the Supreme Court said, dealt with this as a specific case; and not as the application of a general rule of conduct for reorganization managers, and as explanatory of this added:

"Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different."

In this aspect, then, the immediate question is whether the Commission's action in again outlawing petitioners' purchases of stocks, considered in the light of the Supreme Court's opinion, is a permissible exercise of administrative discretion entrusted to it by Congress. We are of opinion that its action cannot be sustained on that ground. The Commission, adhering to its original conclusion, stated its interpretation of the Supreme Court's directive in these words:

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to reexamine the case to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified."

Proceeding on this theory, the Commission declared that the problem is not a question of prescribing a standard of conduct generally applicable to trading "by corporate officers, directors and large stockholders," and expressly declined to adopt a rule applicable in such cases. The Commission says that "without flexibility" such a rule might itself "operate unfairly." It accordingly held that its decision must turn first, upon an affirmative finding by it that the plan was fair and equitable within the meaning of Section 11 (a); second, that it was not detrimental to the interest of investors and consumers under Section 7 (d) (6); and third, that it would not result in an unfair distribution of voting power under Section 7 (e), and concluded that if the record left it with "undispelled doubts" on the first question, the plan should

be proscribed, "even if we (it) made no affirmative finding" in relation to the two other questions. Having reached this conclusion, the Commission, after citing instances in which, in the reorganization of corporations, "management" had availed of opportunities, or temptations, afforded by such proceedings to obtain personal advantage or gain, says that questions of "honesty, full disclosure and purchase at a fair price," traditionally applied to dealings in normal course between corporate managers and stockholders, cannot be the controlling tests * * *. And on this basis the Commission reaffirmed its decision that petitioners' preferred stock must be placed on a different footing than that of other stockholders, saying:

"We are led to this result not by proof that the interveners committed acts of conscious wrongdoing but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration. Doubts, inevitably suggested by the existence of these conflicting interests, remain unresolved and prevent an affirmative finding of fairness and equity under Section 11 (c).

"The existence of such conflicting interests, and the persistence of unanswered questions they generate, similarly furnish the basis for a finding that component elements of the plan, * * * would be 'detrimental' within the meaning of Section 7 (d) (6) and 7 (e)."

The Commission's present view in no substantial respect differs from its original view except that then the Commission grounded its decision "on principles of equity derived from judicial decisions," whereas now it attempts to sustain its position on what it calls its special experience in administering the legislative policy of the Act.

The Commission's position actually amounts to neither more nor less than a definite holding that purchases of stock of a corporation in process of reorganization are unlawful, when made by officers or employees of the corporation—and this without regard to any factor of good or bad faith, or any other factor which might impute special knowledge, secret information, or indeed anything tending to show a lack of bona fides in the transaction. For, as we have seen, the Commission expressly says the integrity of interveners in the respects in which they acted is not at issue. And as to this latter statement, in passing, we may properly observe that it cannot be, for the Commission has put that issue out of the case by its previous admission on the same facts that "honesty, full disclosure and purchase at a fair price" characterized the transactions. In practical effect, therefore, the Commission now insists upon doing precisely what the Supreme Court said it could not

do; that is to say, in applying to this specific case a standard which has never been promulgated, either by the Commission in its regulations or by legislative act, and which the Commission says can not fairly be generally applied.

Considered in this view, we think that the Commission has failed to interpret correctly the limits prescribed for its guidance by the Supreme Court. It is true, as the Commission now asserts, that the Supreme Court recognizes that the Act and its provisions confer upon it broad powers for the protection of the public and that this authority was intended to be responsive to the demands of the particular situations with which the Commission might be faced. But it is also true that the Court recognized that the Commission, like the ocean, has its appointed bounds, and lest it break through its limits and engulf a continent—spoke these words of caution: "The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order as an appropriate safeguard for the interests protected by the Act." And the Court added this further caution that the grounds upon which the administrative agency acts must be clearly disclosed and adequately sustained.

But the Commission has made no additional findings and disclosed no additional considerations to justify its adherence to its former order. In short, its attitude seems to be that Section 11 (c) of the Act, confers a purely discretionary power not subject to judicial review. But we are referred to nothing and can find nothing in the Act to sustain this view. Nor is it sustainable on the theory of Congressional intent, for as we pointed out in our earlier opinion, the Senate Committee's report on submission of the bill declared that the authority of the Commission must be administered within the well defined limits of the Act; and the Act itself certainly confers no such grant of general power.

Section 11 (c), which delineates the Commission's power, reads in part—

"If, after notice and opportunity for hearing, the Commission shall find such plan . . . necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan . . ."

§ 11(c). "In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company . . . may . . . submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company . . . for the purpose of enabling such company . . . to comply with the provisions of subsections (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan . . . [Italic added]

The words of the section—"notice and opportunity for hearing," cannot, we think, be held to erect a standard of judgment so indefinite as to confer unlimited powers, but rather to impose and require quasi judicial action. And as Mr. Justice Brandeis said of similar authority conferred by Section 5 (2) of the Act to Regulate Commerce—⁴

"Upon application of a carrier, the Commission must form a judgment whether the acquisition proposed will be in the public interest. It may form this judgment only after hearing. The provision for a hearing implies both the privilege of introducing evidence and the duty of deciding in accordance with it. To refuse to consider evidence introduced or to make an essential finding without supporting evidence is arbitrary action."

That such a limitation is obviously necessary was recently emphasized by the Supreme Court in the Pottsville case,⁵ in which Mr. Justice Frankfurter said:

"To be sure, the laws under which these agencies operate prescribe the fundamentals of fair play. They require that interested parties be afforded an opportunity for hearing and that judgment must express a reasoned conclusion."

Certainly, a reasoned conclusion must be based on evidence, and may not be pitched alone on unresolved doubts, nor upon weaknesses or selfishness which the Commission believes is inherent in human nature. The construction advanced by the Commission would permit it to exercise a power of disapproval free of judicial review, and the notice and hearing required by the statute would become an empty form. The Commission, free of the inhibitions imposed by the particular facts, would be left to roam the widest possible area of authority influenced and impelled only by its own doubts.

Thus considered, it is apparent that the Commission has made its present order without reliance upon such evidence or findings as would warrant our affirmance. Compare *Labor Board v. Columbian Co.*, 306 U. S. 292-9. In no respect, as we have said, has the Commission made the findings to support the present order as appropriate to effectuate the policies of the Act, or to show that petitioners' actions were other than fair and equitable, or that their participation in the merger scheme would be detrimental to the public interest or to the interest of investors or consumers. In laying down, as it does, a rule of fiat unassociated with the facts in this case, the Commission has strayed from the course

⁴ *Chicago Junction Case*, 264 U. S. 258, 265. See also *Shields v. Utah Idaho R. Co.*, 305 U. S. 177; *Edison Co. v. Labor Board*, 305 U. S. 197-230; *Myers v. Bethlehem Corp.*, 303 U. S. 41, 48-9; *Anniston Mfg. Co. v. Davis*, 301 U. S. 337, 345-6; *St. Joseph Stockyards Co. v. U. S.*, 298 U. S. 38, 51-4; *I. C. C. v. Louisville & N. R. Co.*, 227 U. S. 88, 90-1.

⁵ *Supra*, Note 2, at p. 143-4.

laid out and charted by the opinion of the Supreme Court, and accordingly we must refuse to give it effect.

Mr. Justice Frankfurter, who spoke for the Supreme Court, and whose language we have previously quoted in recognition of the broad powers of the Commission, said of the Commission's former order:*

" * * * Whether and to what extent directors or officers should be prohibited from buying or selling stock of the corporation during its reorganization presents problems of policy for the judgment of Congress or of the body to which it has delegated power to deal with the matter. Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction. *But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stocks in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by §-11 (e), promulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity. The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission.*" [Italics added.]

This language, we think, is equally applicable to the present order, for it is clear now, as it was before, that the Commission has prescribed no fixed standards of conduct which would ban the stock purchases in question, nor promulgated before or since any rule applicable thereto, but, on the contrary, has declined to adopt standards or promulgate a rule, on the ground that no rule or standard which would be fair and equitable in all cases can be made. Certainly, then, it would seem to us to follow that in a case in which the Commission points to no fact challenging good faith, suggests no betrayal of a fiduciary duty, and hints at no use of inside or confidential information, a holding of illegality is

* S. E. C. v. Chenery Corp., 318 U. S. 80, 92-3.

not responsive to the Court's conclusion that "The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public." It may well be, as the Supreme Court suggests, that the Commission's fact-finding functions are like those of a jury. But nothing is more positively imbedded in our law than the principle that a jury may not guess or speculate in deciding facts. Certainly, neither in a court nor before a Commission can an unsupported suspicion sustain a decision.

In nothing we have said do we wish to be understood as expressing any opinion as to the right of the Commission under its broad powers to promulgate a rule of general application forbidding officers and directors of a corporation in process of reorganization from buying—and perhaps also from selling—securities of the corporation during the pendency of proceedings before the Commission. That question is not present in this case. What we do say is that, without such a rule, of which notice is given so that all may know of its existence, transactions in themselves fair and just and honest and in accord with traditional business practices, and which "Congress itself did not proscribe," and which "judicial doctrines do not condemn," may not properly be "outlawed or denied" their ordinary effect.

But here the Commission's position goes beyond the mere question of the necessity of a rule. It insists upon an absolute right to approve in one case and to refuse to approve in another. It says, quite frankly, that it would be inappropriate to condemn a transaction such as we have here in a case in which the cost of the security purchased was in excess of its reorganization value; and again that it might be inconvenient to apply it if to do so would embarrass the corporation's finances. These are but instances which demonstrate its claim to unfettered discretion, irrespective of adequate findings based upon a fair appraisal of the evidence. Nothing that we find in the opinion of the Supreme Court warrants such a conclusion and nothing could be more directly in conflict with the terms and spirit of the law. **Reversed.**

United States Court of Appeals for the District of Columbia

No. 8977—January Term, 1946.

CHENERY CORPORATION, ET AL., PETITIONERS.

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 8978—January Term, 1946

FEDERAL WATER AND GAS CORPORATION, PETITIONER

vs.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petitions for Review of Order of the Securities and Exchange Commission

Before GRONER, C. J., and CLARK and WILBUR K. MILLER, JJ.

United States Court of Appeals for the District of Columbia.
Filed Feb. 4, 1946. Joseph W. Stewart, Clerk.

Judgment and decree

These causes came on to be heard on the transcript of the record from the Securities and Exchange Commission and were argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the order of the said Securities and Exchange Commission on review in these causes be, and the same is hereby, reversed, and that these causes be, and they are hereby, remanded to the said Securities and Exchange Commission for further proceedings not inconsistent with the opinion of this Court.

Per Mr. Chief Justice GRONER.

Dated February, 1946.

In the United States Court of Appeals for the District of Columbia

No. 8977

CHENERY CORPORATION ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 8978

FEDERAL WATER AND GAS CORPORATION, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

United States Court of Appeals for the District of Columbia.
Filed Mar: 12, 1946. Joseph W. Stewart, Clerk.

Designation of record

The Clerk will please prepare and certify a transcript of record on petition for a writ of certiorari to the Supreme Court of the United States in the above-entitled consolidated cases, including therein the following:

1. The Joint Appendix to the briefs of the parties in these cases;
2. Minute entry of argument;
3. Opinion of this Court;
4. Judgment;
5. This designation;
6. Clerk's certificate.

The Clerk is also requested to send to the Clerk of the United States Supreme Court the original record now on file in his office, which will be returned to him when the case has been disposed of by the Supreme Court.

J. Howard McGrath,

J. HOWARD McGRATH,

Solicitor General of the United States.

Service of copy of the above designation of record in the above-entitled consolidated cases is hereby acknowledged this 11 day of March 1946.

Spencer Gordon,

SPENCER GORDON,

Attorney for petitioners Chenery Corporation et al.

Allen S. Hubbard,

ALLEN S. HUBBARD,

Attorney for petitioner Federal Water and Gas Corporation.

United States Court of Appeals for the District of Columbia

I, Joseph W. Stewart, Clerk of the United States Court of Appeals for the District of Columbia, hereby certify that the foregoing pages numbered from 1 to 182, both inclusive, constitute a true copy of the joint appendix to the briefs of the parties and the proceedings of the said Court of Appeals as designated by counsel for respondents in the cases of: Chenery Corporation, et al., Petitioners vs. Securities and Exchange Commission, Respondent, and Federal Water and Gas Corporation, petitioner vs. Securities and Exchange Commission, Respondent, Nos. 8977; 8978, January Term, 1946, as the same remain upon the files and records of said Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the city of Washington, this fourteenth day of March A. D. 1946.

[SEAL]

(S) JOSEPH W. STEWART,

*Clerk of the United States Court of Appeals
for the District of Columbia.*

In the Supreme Court of the United States

October Term, 1945

No. —

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHENERY CORPORATION ET AL., RESPONDENTS

No. —

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

FEDERAL WATER AND GAS CORPORATION, RESPONDENT

Stipulation

Subject to this Court's approval, it is hereby stipulated and agreed by and between the attorneys for the respective parties to the above-captioned cases that:

1. Because the above-captioned cases involve common questions of law and fact, a consolidation will avoid expense and delay, and said cases were consolidated for hearing and decision in the Court of Appeals for the District of Columbia, said cases may

be consolidated for hearing and decision on the petition for a writ of certiorari and, if certiorari is granted, for hearing and decision of the said cases on the merits.

2. For the purpose of the petition for a writ of certiorari and, in the event the petition be granted, for the purpose of hearing and determining these cases on the merits, the printed record shall consist of the following:

a. Joint Appendix to the briefs of the parties in these cases.

b. The proceedings had before the United States Court of Appeals for the District of Columbia.

3. Petitioner will cause the Clerk of the United States Court of Appeals for the District of Columbia to file with the Clerk of the Supreme Court the entire transcript of record in the Court of Appeals for the District of Columbia, and any of the parties hereto may refer in their briefs and argument to said transcript of record, including that part which has not been printed as the Joint Appendix.

J. Howard McGrath,

J. HOWARD McGRATH,

*Solicitor General of the United States,
Attorney for petitioner Securities
and Exchange Commission.*

MARCH 12, 1946.

Spencer Gordon,

SPENCER GORDON,

*Attorney for respondents, Chenery
Corporation et.al.*

MARCH 11, 1946.

Allen S. Hubbard,

ALLEN S. HUBBARD,

*Attorney for respondent Federal
Water and Gas Corporation.*

MARCH 14, 1946.

Supreme Court of the United States

No. 81, October Term, 1946.

Order allowing certiorari

Filed May 13, 1946

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice DOUGLAS and Mr. Justice JACKSON took no part in the consideration or decision of this application.

Supreme Court of the United States

No. 82, October Term, 1946

Order allowing certiorari

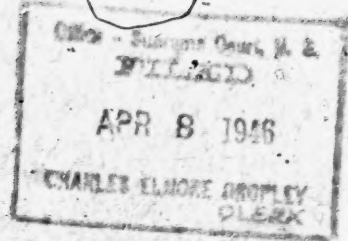
Filed May 13, 1946

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice DOUGLAS and Mr. Justice JACKSON took no part in the consideration or decision of this application.

FILE COPY



Nos. ~~1088-1089~~ 81-82

In the Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER.

v.

CHENERY CORPORATION, ET AL.

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER.

v.

FEDERAL WATER AND GAS CORPORATION

PETITION FOR WRITS OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE DISTRICT OF
COLUMBIA

INDEX

	Page
Opinions below	2
Jurisdiction	2
Questions presented	3
Statute involved	3
Statement	3
Reasons for granting the writ	10
Conclusion	21
Appendix	22

CITATIONS

Cases:

<i>El Paso Electric Co.</i> , 8 S. E. C. 366	20
<i>Mississippi River Power Co.</i> , Holding Company Act Release No. 5779, pp. 27-28 (May 4, 1945)	20
<i>Phelps Dodge Corp.</i> , Matter of, 35 N. L. R. B. 418	16
<i>Phelps Dodge Corp. v. N. L. R. B.</i> , 313 U. S. 177	14, 16
<i>Republic Aviation Corp. v. N. L. R. B.</i> , 324 U. S. 793	16, 17
<i>Securities & Exchange Commission v. Chenery Corporation, et al.</i> , 318 U. S. 80	2, 3, 5, 10, 12, 13, 14, 15, 16, 18, 19, 20
<i>Virginia Electric & Power Co. v. N. L. R. B.</i> , 319 U. S. 533	16
<i>Western Light & Telephone Co.</i> , Holding Company Act Release No. 5902, (July 2, 1945)	20

Statutes:

Public Utility Act of 1935, 49 Stat. 803, 15 U. S. C. §79, et seq.:	
Section 7 (d) (6)	13, 22
Section 7 (e)	13, 22
Section 11 (e)	2, 3, 11, 13, 17, 18, 22
Section 17	13

Miscellaneous:

Report of the Attorney General's Committee on Administrative Procedure in Government Agencies, S. Doc. No. 8, 77th Cong., 1st sess., p. 29	18
--	----

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. —

SECURITIES AND EXCHANGE COMMISSION
PETITIONER

v.

CHENERY CORPORATION, ET AL.

No. —

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER

v.

FEDERAL WATER AND GAS CORPORATION

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

The Solicitor General, on behalf of the Securities and Exchange Commission, prays that writs of certiorari be issued in the above cases to review the judgment of the United States Court of Appeals for the District of Columbia entered February 4, 1946, which reversed the Commission's order of February 7, 1945, issued pursuant to the provisions of the Public Utility Holding Company Act of 1935.

OPINIONS BELOW

The opinion of the Court of Appeals (R. 172-179) has not yet been officially reported. The findings and opinion of the Commission, which accompanied its order of February 7, 1945 (R. 128), are reported in S. E. C. Holding Company Act Release No. 5584.

JURISDICTION

The judgment of the Court of Appeals was entered February 4, 1946 (R. 180). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, which is made applicable by Section 24 (a) of the Public Utility Holding Company Act of 1935.

QUESTIONS PRESENTED

Are the Commission's findings, opinion and order of February 7, 1945, consistent with the decision of this Court in *Securities and Exchange Commission v. Cheney Corporation, et al.*, 318 U. S. 80?

More explicitly, the question is whether the Commission may, on the basis of its administrative experience in effectuating the policies of the Public Utility Holding Company Act of 1935 and as applied to the facts of a specific case, but without issuing a general regulation, impose requirements designed to prevent the management of a company which is the subject of reorganization proceedings under Section 11 (e) of the Act from

profiting from purchases of securities in the course of the reorganization.

STATUTE INVOLVED

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C. 6, Sec. 79 et seq., are set forth in the Appendix, *infra*, pp. 22-23.

STATEMENT

This is the second appearance of this case before this Court. In *Securities and Exchange Commission v. Chenery Corporation, et al.*, 318 U. S. 80 (R. 98), this Court had before it the Commission's order of September 24, 1941, approving the plan of reorganization of Federal Water Service Corporation (Federal) under the provisions of the Public Utility Holding Company Act of 1935. In its findings and opinion the Commission had cited certain equity precedents as applicable under the "fair and equitable" standard of Section 11 (e) of the Holding Company Act. The Commission construed these precedents to require that the management of Federal should not profit through the plan of reorganization by participating on a parity with the public shareholders, with respect to preferred shares they had purchased for control and profit purposes while acting as reorganization managers during the course of the Commission's proceeding. The

Commission's order, in effect, required the management to surrender these preferred shares to Federal Water and Gas Corporation (Federal Water), the new corporation formed in the reorganization, at cost plus four percent interest.¹ This Court held that the Commission had erred in assuming those equity precedents to be controlling, absent findings that "the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers." While this Court indicated that the Commission could have dealt with the problem of trading by reorganization managers in proceedings under the Act on the basis of its special experience in administering the legislative policies of the Act, this Court pointed out that the Commission's opinion did not set forth the findings and considerations which would justify its order on that ground. In setting aside the Commission's order, the Court remanded the case to the Commission "for such further proceedings, not inconsistent with [the

¹ Procedurally, the Commission, in findings and opinion issued March 24, 1941, had indicated, in reliance upon equity precedents, that it would be obliged to find the plan unfair and inequitable unless amended to provide, *inter alia*, for some treatment of the shares acquired by the management that would not involve their profiting through the plan. The plan was subsequently amended to provide for surrender of such shares on the terms stated above and the Commission's order of September 24, 1941, formally approved the plan so amended.

opinion of this Court] as may be appropriate" (R. 111; 318 U. S. 80, 95).

Following the decision and remand of the case, further proceedings were had before the Commission, as a result of which it reaffirmed its prior conclusion in the findings, opinion and order of February 7, 1945 (R. 128, 169).² The Commission's present order was based upon its administrative judgment and experience as applied to the specific facts of the case. The Commission emphasized the characteristically dominant position and powers of Federal's management in the reorganization proceeding under the Act and their duty to bring about with reasonable promptness a fair, equitable and appropriate plan.³

² In form this Court's remand was to the Court of Appeals for the District of Columbia, which had set aside the Commission's order, for remand by that court to the Commission on the terms quoted above.

³ Although no additional evidence was taken in the Commission's further proceedings, briefs were filed and oral arguments were heard (R. 129).

⁴ Federal's preferred stockholders had received no dividends since 1931. At the time of the Commission's proceeding earnings were currently available but the management was precluded from declaring dividends because of a recognized capital impairment. The special powers of Federal's management were found to flow from normal corporate powers combined with special reorganization powers vested in a holding company management in proceedings under the Act. Normal corporate powers allowed Federal's management to regulate the corporate and system accounts, time the solution of major financial problems of the subsidiaries, regulate the flow of earnings, and ultimately affect the dividend status and market value

It held that the consequence of their embarking upon a substantial program of purchasing Federal's preferred stock created a conflict between their personal interest in effectuating the purchase and the proper discharge of their obligations to the public security holders, including those from whom they purchased the preferred stock.

states, the Commission's experience led it to conclude that (R. 156-159)—

The combination of these multiple powers in the management while a reorganization is under consideration places at its command a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute. If, in this setting, the management enters upon

of the preferred stock. Special reorganization powers enabled Federal's management to control the terms and timing of the plans, the negotiations with the Commission's staff over plans and changes of plans, including the respective participations of the various classes of stocks, and the public announcements of plans. This combined battery of powers permitted Federal's management to be spokesmen for all public security holders as well as themselves in the reorganization proceeding. The Commission also found that Federal's management held numerous important positions throughout the system—a finding of considerable importance on the question of their struggle for preservation of control since such positions unquestionably carried with them substantial perquisites in salary and prestige.

a stock purchase program there is inevitably the temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices. Public announcements by the management can be directed to that end. Steps can be taken that may delay and protract the proceedings in such a manner as to make senior stockholders lose hope of receiving dividends within a reasonable time and induce some of them to sell out at a sacrifice.

* * *

When * * * members of a management determine to obtain personal advantage out of a reorganization by engaging in a program of buying outstanding securities, for the purpose of realizing either the voting power or the enhanced value they expect those securities to have in the reorganized corporation, or both, the conflict is [neither] normal or unavoidable. The managers then have undertaken to act affirmatively in their own interest, with reference to the reorganization, and anything they gain therefrom must necessarily be at the expense of persons whom they are under a duty to represent. At that point, any management, no matter how honorable, makes its own motives suspect. Indeed, once it enters upon such a program even its acts prior to reorganization are compromised in retrospect because for all practical purposes it is impossible for anyone, attempt-

ing at a later time to trace back and sort out the motives that guided such action, to reach a firm conclusion that managerial judgment was not in at least some respects exercised in contemplation of the personal gain to be realized ultimately from the reorganization.

It is our view that no management of a holding company can engage in a program of buying its company's stock during the course of a reorganization under the Act, without raising the probability that in one way or another the personal interests it seeks to further through its program will be opposed to its duties to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously. The natural inclination of any person to buy cheaply, coupled with the normal and extraordinary powers of a holding-company management to further that objective by creating the conditions which make cheap buying possible during the course of a reorganization before us, are bound to create a risk—perhaps in some cases merely potential but in all cases very real—of harm to all of the company's public security holders whether, or not they elect to sell. In such a case the managers are not buying merely against future market risks. They are buying against a reorganization which they themselves are planning, during

a period in which they exercise, as far as the corporation is concerned, a dominant influence over most of the factors that affect the progress and outcome of the reorganization, including not only the daily operations of the system companies but also, to a very large extent, the timing of steps to be taken on behalf of the reorganizing company and public statements concerning the entire enterprise.

In making no finding that the conduct of this particular reorganization was in fact influenced or affected by the antagonistic self-interest of Federal's management, the Commission could not and did not make the converse finding that their conduct was in no way influenced thereby.⁵ On the

⁵ The Commission in its present opinion has explained the wholly argumentative meaning which it had intended to convey by the so-called "admissions" of fair dealing on the part of Federal's managers, as referred to in this Court's opinion (R. 164). What the Commission meant in its original opinion, and what its counsel in briefs and argument upon appeal had assumed, was merely that the inflexible rule of equity on which it originally relied did not even permit inquiry into the question whether the transactions of the reorganization managers here were characterized by "honesty, full disclosure and purchase at a fair price." The opinion of the court below not only ignores the Commission's explanation of why it actually made no findings whatever on the subject of the good or bad faith of Federal's managers, but instead emphasizes again and again, without any foundation in the record, what it terms affirmative findings that "petitioners' purchases of stock were in all respects fair, honest and above-board, resulting neither in any unjust enrichment to themselves nor harm to other stockholders or the public" (R. 175), and that "the result was neither unfair nor

contrary, for reasons set forth in its opinion (R. 158-64), the Commission concluded that it could not probe all of the subtle factors which might tend to show conscious wrongdoing in any course of action undertaken in a particular reorganization proceeding.

Upon petitions for review filed by Chenery Corporation, et al. (R. 2) and by Federal Water and Gas Corporation (R. 14), the court below reversed the Commission's order in a decision more fully discussed below.

REASONS FOR GRANTING THE WRIT

The court below considered—and we agree—that the basic question before it was “whether the Commission has rightly construed and rightly followed” the opinion of this Court in the first *Chenery* case (R. 174). As the court below declared, “the Supreme Court can itself best answer this question.” (R. 174). We submit that in reversing the Commission's order for failure to comply with this Court's opinion the court below interpreted that opinion as imposing restrictions on the Commission's administration of the policies of the Act which this Court specifically disclaimed. As this Court recognized in granting the writ of certiorari to review the first *Chenery* case, the question here of management trading during the course of a reorganization under the Holding Company Act is one of importance which “looms inequitable to the persons affected by the plan” (R. 174). See R. 174-177. The Commission has made no such findings.

large in the administration of the Act." (R. 99; 318 U. S. 81).

I. As we understand it, the court below interpreted this Court's opinion to mean that, absent findings of conscious wrongdoing, the Commission was not authorized to determine by order in the particular case whether it was consistent with the "fair and equitable" standard of Section 11 (c) of the Act to permit Federal's management to realize a profit through their purchases. The court below referred to the possibility that the Commission might, by a rule applicable to future transactions, protect investors against the risks of harm from management's antagonistic interest in making purchases in the course of the reorganization. Without expressing an opinion on the permissibility of such a rule, the court below held "that, without such a rule, of which notice is given * * *" the purchases here involved "may not properly be 'outlawed or denied' their ordinary effect" (R. 179). Apparently the court below saw no rational basis for the Commission's conclusion that it could not affirmatively find "fair and equitable" in the case before it a plan which would enable the management of Federal to profit by purchases which inherently carried with them, at least, the potentiality of harm to investors. In so far as that holding purports to rest upon this Court's opinion, we believe it twists a holding that the Commission's earlier decision was not supported by the equity precedents on which the Com-

mission relied into a holding that principles of "fairness and equity" so clearly sanctioned the management purchases as to make it arbitrary for the Commission—despite its administrative judgment as to the risk of harm to investors—to limit the management to cost in this case.

We cannot so construe this Court's opinion. We believe that the opinion read as a whole shows that this Court was remanding the case to the Commission for the exercise by it of an administrative discretion, in the light of principles enunciated in the decision, to decide by order what result would be required by the application of the statutory standards to this particular case. As this Court said "Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts. But these standards are not static." (R. 105-6; 318 U. S. 89.) The court below, holding that in the absence of a showing of conscious wrongdoing the Commission can act only by prospective regulation, treated this Court's opinion as leaving the Commission no choice but to permit parity treatment to the purchases by Federal's management. We note below specific references to portions of this Court's opinion which seem to us wholly inconsistent with that interpretation.

A. This Court was at pains to explain that the Commission's original opinion had to be reviewed solely on the basis of the "grounds * * * upon which the record discloses that its action was based",

i. e., "the principles of equity announced by courts," and not the administrative considerations on which the Commission "urges here that the order should nevertheless be sustained." (R. 104, 106; 318 U. S. 87, 90.)

B. In refusing to determine whether the Commission's order might be sustained upon considerations urged in its brief but not explicated in the Commission's original opinion, this Court explains why it deemed inapplicable to an administrative order the rule under which a judicial decision may be affirmed on other grounds, although the reviewing court rejects the grounds upon which the lower court's decision was based. (R. 104-5; 318 U. S. 88.)

C. In rejecting the theory on which the court below reversed the earlier order of the Commission, this Court did not affirm upon different grounds. The earlier decision had required parity of treatment for the management, holding that Section 17 (applicable to short term trading) expressed the limits of the Commission's powers to deal with management's purchases in the course of a reorganization under the Act. On the contrary, this Court recognized and described at length the extraordinary reorganization powers exercised by Federal's management and concluded that Sections 7 (d) (6), 7 (e) and 11 (e) were intended "to confer upon the Commission broad powers for the protection of the public" against reorganization abuses; and that Section 17 was not a "limitation upon the power of the

Commission to deal with other situations in which officers and directors have failed to measure up to the standards of conduct imposed upon them by the Act." (R. 107-8; 318 U. S. 90-92.)

D. Finally, the court below wholly disregarded the gist of this Court's rulings, as stated by way of recapitulation in the next to the last paragraph of its opinion, that the Commission's administrative judgment in an area entrusted to it by Congress may not be set aside "because the reviewing court might have made a different determination were it empowered to do so"; that the words of *Phelps Dodge Corp. v. N. L. R. B.*, 313 U. S. 177, 197, that "all we ask of the Board is to give clear indication that it has exercised the discretion with which Congress has empowered it," were "equally applicable here"; that this Court's decision was not "imposing any trammels on [the Commission's] powers"; and that this Court was "merely" holding in this case "that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained." (R. 110-11; 318 U. S. 94-5.)

2. The court below objected to the Commission resting its present decision upon its administrative judgment as to the probability of harm to investors, without proof of conscious wrongdoing in the particular case. The court below characterized this action by the Commission as "laying down a rule of fiat," and as a decision based upon

"an unsupported suspicion," "unresolved doubts" and "weaknesses or selfishness which the Commission believes is inherent in human nature." (R. 178-179)* According to the court below, the effect of countenancing such administrative action is to permit the Commission "to exercise a power of disapproval free of judicial review" and to leave the Commission "free of the inhibitions imposed by the particular facts * * * influenced and impelled only by its own doubts." (R. 178.)

Without disputing the rational basis for the Commission's inferences derived from its experience with reorganizations, the court below makes the difficulty of subjecting such an administrative judgment to judicial review a ground for precluding its exercise. In limiting the Commission to the possibility of dealing with the problem by a prospective regulation or rule it wholly ignored the statutory necessity for affirmative findings to uphold the plan by order as fair and equitable, and gave little, if any, weight to this Court's intimation that "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction."

(R. 179; 318 U. S. 92.)

The lower court's refusal to consider the Com-

* Thus censuring the Commission's skeptical appraisal of the management's transactions, the court below substituted its own judgment which, in effect, viewed the purchase program as no more than a sound business practice. (R. 179.)

mission's decision as a general standard or policy laid down in the particular case through adoption of the traditional common law technique is not only wholly at variance with our reading of this Court's opinion in the *Chenery* case, but is inconsistent with *Republic Aviation Corp. v. N. L. R. B.*, 324 U. S. 793, in which this court upheld the use of a similar technique by the National Labor Relations Board. See also *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, 543; *Phelps Dodge Corp. v. N. L. R. B.*, 313 U. S. 177.

"In charging that the Commission "says" the standard laid down in this case "can not fairly be generally applied" (R. 176); that the Commission makes a "claim to unfettered discretion"; and "insists upon an absolute right to approve in one case and to refuse to approve in another," (R. 179) the court below has misread the Commission's observations as to why even a formal written rule would not eliminate the case by case necessity of determining on given facts when the rule is or is not applicable, and of varying the form of the remedy to meet the needs of specific cases. (R. 166-68, and note 31.)

"In *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, 543, this Court declared: "It is * * * wrong * * * to force [the Board] to inquire into the amount of damages actually sustained. Whether and to what extent such matters should be considered is a complex problem for the Board to decide in the light of its administrative experience and knowledge."

"Following the remand of this Court in the *Phelps Dodge* case, the Board reaffirmed its determination on grounds which it declared "do not vary from case to case." *Matter of Phelps Dodge Corp.*, 35 N. L. R. B. 418, 421. This reaffirmed decision was enforced by the Circuit Court of Appeals for the Second Circuit in an unreported judicial order without opinion.

Contrary to the intimations of the court below, the Commission's present opinion does set forth a rational basis for its judgment on the undisputed facts. See, *inter alia*, the excerpt quoted *supra* pp. 6-9. What the court below lost sight of in its condemnation of the Commission's present decision is that there was ample room for judicial review of the Commission's findings in the present case—or would have been if the management had seriously challenged either the substantiality of the evidence, so far as the findings of fact are concerned, or "the rationality between what is proved and what is inferred," insofar as the Commission's conclusion was integrated with its special experience. See *Republic Aviation Corp. v. N. L. R. B.*, 324 U. S. 793, 805.

3. In holding that this Court's opinion precluded the Commission from coping with the problem of managerial purchases during the course of a reorganization under the Act, except by a general rule operating prospectively "so that all may know of its existence," (R. 179) the court below has misconstrued as a holding certain references by this Court to the Commission's rule-making powers under Section 11 (e) of the Act (R. 175).¹⁰ As we

¹⁰ The expressions of this Court quoted by the court below in support of the latter's holding that the Commission could act only by general rule, are as follows:

"* * * Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the

read this Court's opinion we think it clear that those remarks of this Court were intended only as illustrative of the courses of action open to the Commission in acting in this field. This Court had before it the provisions of Section 11 (e) and was plainly aware that that section authorized the Commission to supervise the conditions under which plans are proposed, by *order* as well as by rules and regulations, and indeed the Commission may approve a plan only by "order". Accordingly, this Court could not have intended to prevent the Commission from deciding this specific case on the basis of general administrative experience evolved and applied in the case by case procedure clearly contemplated by the section.¹¹ This course seems to us unquestionably within the scope of this Court's mandate, in the light of this Court's opinion read as a whole. By contrast, the holding of the court below makes this Court's remand merely a direction to approve the plan which the Commission had previously disapproved.

problem for our consideration would be very different * * * Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11 (e), promulgated new general standards of conduct." (R. 108-9; 318 U. S. 92-3).

¹¹ See Report of the Attorney General's Committee on Administrative Procedure in Government Agencies, S. Doc. No. 8, 77th Cong., 1st Sess., p. 29.

What the court below thus overlooked is that the Commission was dealing with a particular case which could be disposed of only by *order* and only after the Commission had determined whether, on the basis of particular facts viewed in the light of its experience, it could or could not find the plan "fair and equitable". No general rule of any type whatsoever could have obviated the necessity for acting by order in relating that rule to the facts of the particular case. In consequence, it is of no bearing upon respondents' case either before the Commission or the courts that there was no previously announced rule, unless, as respondents' urged here in the first case and in the court below in the present case, the promulgation of a general standard in the decision of the particular case raises questions of improper retroactivity.

Careful analysis of the arguments that might be raised as to retroactivity in a case such as this would show that the issue presented is, in essence, whether the specific considerations brought to bear on the issues by the Commission can fairly be said to be inherent in applying the standards and policies of the Act. If they are, there is no improper retroactivity but merely implementation of the statutory command. This Court expressly found that the statute provided a firm basis for the power exercised by the Commission (R. 107-8; 318 U. S. 90-92). In so finding, this Court, we believe, finally and definitively pre-

cluded the raising of any issue of improper retroactivity in this case.

While the Commission has in some instances (not involving reorganization managers) announced for the future a new administrative policy not applied to the problem before it,¹² in this instance the Commission concluded that it should not thus limit action for the protection of investors because the consequence "would give the interveners a premium for risking the interests of the public investors, to the detriment of the latter, and, as well, to the detriment of investors in many other holding company securities, and of the public interest, within the meaning of Sections 7 (d) (6) and 7 (e)." (R. 166.) To have held that reorganization managers may pursue their personal advantage at the risk of harm to public security holders and profit thereby merely because the government agency has not expressly forbidden them against such conduct would permit the "lax view of fiduciary obligations" which this Court rejected (R. 102; 318 U. S. 85).

¹² See, *El Paso Electric Co.*, 8 S. E. C. 366, 377-78 (1940); *Mississippi River Power Co.*, Holding Company Act Release No. 5776, pp. 27-28 (May 4, 1945) and *Western Light and Telephone Co.*, Holding Company Act Release No. 5902 (July 2, 1945). In those cases, unlike the present case, reliance upon the existence of prior Commission decisions which might have been considered to have reached a contrary result was held to justify non-application of the newly announced standards in the pending case.

CONCLUSION

Because the decision of the court below misconstrues the decision of this Court in the first *Chenery* case, fails to follow other applicable decisions of this Court, and wrongly decides a question of public importance in the administration of the Act, the petition for a writ of certiorari should be granted.

Respectfully submitted.

J. HOWARD McGRATH;
Solicitor General.

ROGER S. FOSTER,
Solicitor,
Securities and Exchange Commission.

APRIL 1946.

APPENDIX

Section 7 (d) (6) of the Public Utility Act of 1935 (49 Stat. 803, 15 U. S. C. § 79, *et seq.*), in pertinent part, provides:

If the requirements of subsections (e) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

* * * * *

the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

Section 7 (e) provides:—

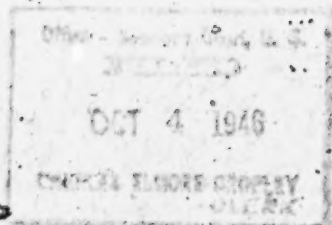
If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

Section 11 (e) provides:

In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding com-

pany or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

FILE COPY



Nos. 81 and 82

In the Supreme Court of the United States

OCTOBER TERM, 1946

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHENERY CORPORATION, ET AL.

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

FEDERAL WATER AND GAS CORPORATION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE SECURITIES AND EXCHANGE
COMMISSION

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	3
Statement	3
Specification of errors	17
Summary of argument	18
Argument:	
I. The Commission's present order conforms to the prior mandate of this Court	22
II. The Commission's present findings and opinion disclose a rational and competent exercise of its administrative discretion in the application of the statutory standards	32
III. The Commission was entitled to formulate the stand- ard applied in this case by order and was not limited to acting by a general rule	51
Conclusion	58
Appendix	59

CITATIONS

Cases:

<i>Addison v. Holly Hill Fruit Products, Inc.</i> , 322 U. S. 607 ..	28, 57
<i>El Paso Electric Co.</i> , 8 S. F. C. 366 ..	57
<i>Federal Communications Commission v. Patuxent Broad- casting Co.</i> , 309 U. S. 134 ..	29
<i>Gonsch v. Walling</i> , 324 U. S. 244 ..	51
<i>Havender v. Federal United Corporation</i> , 6 A. 2d 618 ..	7, 8, 41
<i>Havender v. Federal United Corporation</i> , 11 A. 2d 331 ..	8
<i>In re Community Power & Light Co.</i> , 33 F. Supp. 901 ..	8
<i>Mississippi River Power Company</i> , — S. E. C. — ..	57
<i>Otis & Co. v. Securities and Exchange Commission</i> , 323 U. S. 624 ..	7
<i>Phelps Dodge Corp. v. Labor Board</i> , 313 U. S. 177 ..	30, 51, 52
<i>Republic Aviation Corp. v. N. L. R. B.</i> , 324 U. S. 793 ..	48, 49, 52
<i>Securities and Exchange Commission v. Chetery Corpora- tion, et al.</i> , 318 U. S. 80 ..	2, 18, 22
<i>Virginia Electric & Power Co. v. N. L. R. B.</i> , 319 U. S. 533 ..	45, 49, 51, 52
<i>Western Light and Telephone Company</i> , — S. E. C. — ..	57

II.

Statutes:

Page

Bankruptcy Act of 1938 (11 U. S. C. §§ 572, *et seq.*)
 Section 77B, as augmented in 1938 by Sections 212 and 249

of Chapter X.....	56
Sec. 172.....	50
Sec. 179.....	50
Sec. 190.....	50
Sec. 208.....	50
Sec. 212.....	51
Sec. 222.....	50
Sec. 247.....	50
Sec. 265a.....	50

Investment Company Act of 1940, (15 U. S. C. § 80a-35)

Sec. 36.....	50
--------------	----

Public Utility Holding Company Act of 1935 c. 687, 49

Stat. 803 (15 U. S. C. Sec. 79 *et seq.*)

Sec. 2 (a) (7).....	12
Sec. 2 (a) (8).....	12
Sec. 7 (d) (6).....	26, 59
Sec. 7 (e).....	26, 59
Sec. 11 (b).....	8
Sec. 11 (e).....	8, 28, 29, 36, 55, 59
Sec. 17 (b).....	50
Sec. 24 (a).....	15, 17

Securities Exchange Act, Sec. 16 (b).....

50

Miscellaneous:

Report of the Securities and Exchange Commission on
 Investment Trusts and Investment Companies (1938-
 1942), Parts 1-5.....

50

Securities and Exchange Report on the Study and Investi-
 gation of the Work, Activities, Personnel and Functions
 of Protective and Reorganization Committees (1937-
 1940), Parts I-VIII.....

50

Securities and Exchange Commission Holding Company
 Act.....

Release No. 5584.....	2
Release No. 5776.....	57
Release No. 5902.....	57

S. Doc. No. 8, 77th Cong., 1st Sess.....

53

S. Rep. No. 621, 74th Cong., 1st Sess.....

37, 56

S. Rep. No. 1916, 75th Cong., 3d Sess.....

51

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 81

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

CHENERY CORPORATION, ET AL.

No. 82

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

FEDERAL WATER AND GAS CORPORATION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE SECURITIES AND EXCHANGE
COMMISSION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 172-80) is reported in 154 F. 2d 6. The findings and opinion of the Commission, which accompanied its order of February 7, 1945 (R. 128), are reported in S. E. C. Holding Company Act Release No.

5584. Earlier opinions of the Court of Appeals and of the Commission which were considered by this Court in its decision reported in 318 U. S. 80 are set forth, respectively, in 128 F. 2d 303 and 8 S. E. C. 893. See also supplemental findings and opinion of the Commission and report of the Commission on the plan of reorganization which are reported in 10 S. E. C. 200.

JURISDICTION

The judgment of the Court of Appeals was entered February 4, 1946 (R. 181). The petition for writs of certiorari was filed April 8, 1946, and was granted May 13, 1946 (R. 184-185). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, which is made applicable by Section 24 (a) of the Public Utility Holding Company Act of 1935.

QUESTION PRESENTED

Are the Commission's findings, opinion and order of February 7, 1945, consistent with the decision of this Court in *Securities and Exchange Commission v. Chenery Corporation, et al.*, 318 U. S. 80?

More explicitly, the question is whether the Commission may, on the basis of its administrative experience in effectuating the policies of the Public Utility Holding Company Act of 1935 and as applied to the facts of a specific case, but without having issued a general regulation, im-

pose requirements designed to prevent the management of a company which is the subject of reorganization proceedings under Section 11 (e) of the Act from profiting from purchases of securities in the course of the reorganization.

STATUTE INVOLVED

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C., Sec. 79 et seq., are set forth in the Appendix, *infra*, pp. 59-60.

STATEMENT

(a) *The Relevant Factual Background.*—When this case began on November 8, 1937, Federal Water Service Corporation (Federal) was a public utility holding company registered under the Public Utility Holding Company Act of 1935 and controlling a public utility system of 42 subholding and operating subsidiaries with water, gas, electric and other properties in 13 states and 1 foreign country. Federal had been incorporated in 1926 under the laws of Delaware. Its Class B common stock, which had the voting control, was originally held by Tri-Utilities Company, a public utility holding company. Its preferred and Class A stocks, with limited voting rights, had been issued and sold to the public.

¹ Since the facts are not in dispute we do not make detailed citations to the printed record but refer the Court to the detailed findings set forth in the Commission's opinion (R. 128, *et seq.*).

After Tri-Utilities went into receivership in 1931, the Class B stock of Federal, which had been previously pledged by Tri-Utilities as security for loans, was sold by the bank pledgees to C. T. Chenery, president of Federal, and other officers, directors and employees of Federal and its subsidiaries who had pooled funds to buy the stock at a net cash cost of about \$605,249. The purchases were made through Utility Operators Company (Operators), which Chenery and the others had formed to hold the Class B stock and to issue its own capital stock to the various participants in the venture (R. 131-33).

When the Commission's proceeding began, the respondents in Case No. 81 held about one-third of Operators' stock, including approximately 16 percent thereof which was held by Chenery individually and through his personal holding company, Chenery Corporation. The balance of Operators' stock was scattered among approximately 1,700 persons who were for the most part still employees of Federal and its subsidiaries (R. 132).

At the time Federal registered under the Holding Company Act it was in need of a stock reorganization. Its capitalization included \$6,893,500 principal amount of 5½ percent debentures; \$15,189,039 aggregate stated value of preferred stock (four series); \$13,666,733 stated value of Class A stock, and \$2,500,000 stated value of Class B stock. No dividends had been paid on any class

of Federal's stocks since 1931 and there were arrearages on the preferred stock of nearly \$6,000,000 and on the Class A stock of approximately \$7,000,000. The annual dividend requirements on those stocks were about \$1,000,000 for each class. An earned surplus deficit which had exceeded \$568,000 at the end of 1932 had grown to more than \$2,400,000 by the end of 1937, at which time the net deficit in all of Federal's surplus accounts equaled about half the stated value of the Class B stock. The fair value of Federal's investments in its subsidiaries was disclosed to be at least \$5,000,000 less than their \$35,477,000 carrying value.² Because of this capital impairment, dividends could not be paid out of the current income of approximately \$712,000 which Federal had received during the two year period 1936-37 (R. 132-34).

In consequence of the dividend arrearages on the preferred and Class A stocks, the Class B stock (which normally carried the entire voting control)³ had 42.73 percent of the voting power; 44.80 percent of the voting power was held by the Class A and 12.47 percent by the preferred. Since, however, these latter classes were widely

² An appraisal report filed by Federal at the time of registration showed the fair value of its investments to be fully \$10,000,000 less than carrying value.

³ Except in special situations, i. e., the creation of liens, the issuance of new prior preference stock, and the election of three of the seven directors.

distributed among approximately 16,000 public stockholders, the Class B stock retained the full working control of Federal and its operating subsidiaries. Because of the similar dispersion of two-thirds of the voting stock in Operators, which held all of Federal's Class B stock, Chenery and the other individual respondents, through their combined one-third interest in Operators, had the ultimate control of the entire system (R. 134, 132).

Federal's financial condition, particularly the capital impairment and inability to distribute current earnings as dividends, had occasioned attempts at reorganization under Delaware law prior to Federal's registration under the Holding Company Act. A plan of October 1936 had been abandoned because it fell afoul of Delaware law in failing to provide for payment of the dividend arrearages. Another plan had been discussed informally with the Commission's staff a few months before Federal registered but was abandoned following adverse criticism of the staff. This second pre-registration plan provided for a pro rata reduction of the capital allocated to each class of Federal's stock. The staff criticism had been directed to the feature that the capital represented by the senior classes was to be reduced far below their respective liquidating preferences (R. 134-35).

Between November 8, 1937, when Federal registered, and March 30, 1940, Federal proposed four plans of reorganization. Each plan was

proposed for the stated purpose of curing the capital impairment and permitting dividends to be paid and, as well, of bringing Federal's capital "in line with the present value of its assets and its earning power and the provisions of" the Holding Company Act (R. 135).

The first two of Federal's post-registration plans were adversely criticized by members of the Commission's staff, whose basic position was that the Class B stock was worthless and that, accordingly, it was objectionable to give that stock any interest in assets, earnings or voting power through a reorganization. The management, on the other hand, insisted that the Class B stock was entitled to participate.⁴ The third plan, filed May 11, 1939, was withdrawn by Federal's management in August of that year because the decision of the Delaware Court of Chancery in *Hav-*

⁴The management contended that in addition to voting control it was getting up prospects of future value in the B stock in event of inflation. It should be noted, however, that the A stock, senior to the B stock to the extent of \$13,666,733.50 of stated value and approximately \$11,000,000 of dividend arrearages, was accorded only a marginal participation of about 5 percent under the final plan as approved by the Commission, and Commissioner Healy dissented from approval thereof on the ground that the A stock was entitled to no participation. The issue of whether the A stock was entitled to any participation was similar to that upon which the Commission and this Court divided in the *United Light & Power* case. (See *Otis & Co. v. S. E. C.*, 323 U. S. 624). The Commission was unanimous in holding that there was no conceivable basis for participation for the B stock.

ender v. Federal United Corporation, 6 A. 2d 618, cast doubt upon the propriety (so far as Delaware law is concerned) of certain provisions of that plan with respect to the deferring of payments of the dividend arrearages on the senior stocks.⁵ (R. 136.)

When that decision was reversed by the Supreme Court of Delaware in *Havender v. Federal United Corporation*, 11 A. 2d 331, with the holding that preferred dividend arrearages could be eliminated under Delaware law through a statutory merger, Federal's management submitted its fourth plan to the Commission. This plan, filed March 30, 1940, with subsequent amendments, be-

⁵ Because of alleged doubts as to the constitutionality of Section 11 (e) of the Act, the company did not seek to avail itself of the reorganization machinery of that Section (R. 65-66; Tr. 1905-1906), whereby the Commission may apply to a federal equity court to enforce a plan without the consents required by state law if the plan is found fair and equitable and necessary to effectuate the provisions of Section 11 (b), and if the company requests such enforcement. When Federal's plans were filed, there existed no judicial precedent for the enforcement of a plan approved by the Commission under Section 11 (e). The constitutionality of Section 11 (e) was not judicially determined until June 15, 1940, in *In re Community Power & Light Co.*, 33 F. Supp. 901 (S. D. N. Y.) Federal itself reserved the right to challenge the constitutionality of all provisions of the Act except the registration provisions (see, e. g., Tr. 26, 516, 794, 1905-1906, 3220-3221). Under the company's self-imposed limitations, the plan could be accomplished only by charter amendments and other devices provided by the laws of Delaware.

The symbol "Tr." refers to the unprinted portions of the Commission's transcript of record to which by stipulation counsel may refer.

came the basis for the Commission orders under review and is referred to herein as the final plan. As filed, the final plan provided for a merger of Federal with Operators and Federal Water & Gas Corporation, a wholly-owned subsidiary of Federal which had few assets and existed primarily to preserve that corporate name for Federal's use. The surviving corporation was to have a security structure consisting of a single class of common stock, in addition to the theretofore outstanding debentures of Federal, not affected by the plan. This new common stock was to be allocated, about 90.7 percent to Federal's public preferred stockholders, about 5.38 percent to Federal's Class A stockholders, and about 3.92 percent in exchange for assets of Operators other than its holdings ~~for~~ Class B stock of Federal. These assets of Operators consisted of several thousand shares of Federal's preferred stock (acquired prior to November 8, 1937), some of Federal's debentures, and a small amount of miscellaneous assets (R. 136-37).

Throughout the period of staff discussions, hearings and consideration of the earlier plans, a basic divergence in point of view was reflected in the staff insistence that the Class B stock was worthless from an earnings and asset standpoint and not entitled to participate in any plan, while the management was unwilling to go along with any program which would involve its elimination from participation. In the final plan, however, the only provision giving any consideration to

Federal's management for its holdings, through Operators, of Federal's Class B stock, was a requirement that the directors be elected for staggered terms of office. While the Commission's staff had suggested that this provision might prove acceptable, the Commission had not committed itself on the subject. (R. 137.)

At the request of Federal, the Commission on June 29, 1940, issued tentative findings and opinion on this plan. These findings, which were not made public and were available only to the parties, indicated approval of the principal features of the plan but disapproved of the provision for a staggered board and questioned the propriety of permitting preferred stock purchased by the management during the pendency of the reorganization to participate on the same basis as that provided for other preferred shares. (R. 139.)

These management purchases of preferred stock had been made throughout the period of the reorganization proceedings down to the time of issuance of the Commission's tentative findings and opinion. The purchase program had been sponsored by Chenery, who testified that as early as 1938 the staff's attitude toward the B stock had indicated to him the possibility that the management might ultimately lose on that issue and that, accordingly, he had advised fellow officers and employees who held Operators' stock to buy as much preferred stock as they could carry as a "secondary line of defense." Even before the first

plan was filed, however, Chenery and his personal holding company had acquired 2,164 shares of Federal's preferred stock; of this about 600 shares had been bought in the few days immediately before public announcement of the first plan. At the Commission's hearing on the first plan, a stockholder had criticized these pre-filing purchases. Shortly thereafter, Federal's management met and agreed not to buy any stock while negotiations for a plan were pending and as long as the terms of the plan were not publicly disclosed. (R. 137-38.)

Thereafter, until June 30, 1940, when purchases ceased, C. T. Chenery and Chenery Corporation purchased 8,618 shares of Federal's preferred stock and other members of the management purchased 3,789 shares at various times which they deemed to be permissible under their agreement. All of the stock was acquired through brokers in the open market, excepting 2,700 shares which Chenery acquired in a block from a securities dealer upon an exchange for \$100,000 principal amount of Federal's debentures. A substantial part of the shares were bought at prices in the middle 20's and for a few shares they paid prices in the middle 30's. Reports of these purchases were filed with the Commission pursuant to Section 17 (a) of the Holding Company Act. (R. 138.)

The preferred shares which Chenery and other members of Federal's management acquired dur-

ing the course of this reorganization proceeding cost in the aggregate \$328,347. The final plan, as originally proposed, provided for an exchange of those shares for new common stock of the surviving corporation having an aggregate book value of \$1,162,431.⁶ The voting power in the new common stock which Federal's management was to obtain for its preferred stock acquisitions was 7.4 percent of the total voting power. In addition, Federal's management stood to receive 2.7 percent of the voting power in the surviving corporation for preferred stock acquired prior to the filing of the first plan and for its approximately one-third interest in the several thousand preferred shares and other assets of Operators. In all, the management stood to obtain 10.1 percent of the total voting power in the reorganized corporation. (R. 138-39.)⁷

⁶ This book figure was substantially more than the Commission's estimates of what the new common stock could be sold for initially in the market. The final plan as originally filed assigned the new common stock a par value of \$12 per share; as finally approved the plan accorded a par value of \$5 per share for the new stock, pursuant to the Commission's request that par value be brought into line with the probable market value of the new stock. On this reduced basis the management would have received for the preferred stock which it acquired during the course of the reorganization new common stock having an aggregate par and probable market value of approximately \$395,385 as compared with an aggregate cost of \$328,347 for the shares.

⁷ The Holding Company Act (Sections 2 (a) (7) and 2 (a) (8) makes 10 percent or more of voting power presumptive of control.

Following the issuance of the Commission's tentative findings and opinion, the hearings on the final plan were reconvened, and Chenery and other members of the management testified extensively as to their reasons for acquiring the preferred stock and conditions under which they had made their purchases. Their testimony, quoted extensively in the Commission's findings and opinion under review, showed clearly a determination on the part of interested members of the management to acquire the stock primarily as a means of preserving their control over Federal and its system and secondarily because of their recognition of the increased investment value which that stock would be likely to have in the future. The stock was considered to be the management's bulwark against the day when they might have to accede to a plan which gave no recognition to the Class B stock. (R. 141-144.)

In view of the provisions of the final plan with respect to the staggered election of directors and for ~~accord~~ing equal participation to the preferred stock which the management had acquired during the reorganization, the Commission on March 24, 1941, issued its findings and opinions concluding that it could not approve the plan under the pertinent provisions of the Act unless certain changes were made. These comprised a reduction of the par value of the new common stock, elimination of the provision for election of directors to staggered terms, and the framing of some

provision which would accord only a limited participation to the management's reorganization purchases of the Federal preferred stock. As amended, the plan provided that the preferred stock purchased by the management during the course of the reorganization and which was still held by the management, should be surrendered to the surviving corporation for retirement at cost plus 4 percent interest from the dates of purchase to the effective date of the merger. As to the preferred shares which had been acquired and thereafter sold during the reorganization, the plan provided that the management should surrender the profit on such sales less 4 percent interest on the cost. (R. 144-145.)

C. T. Chenery and the other members of the management thus affected by the plan as amended objected to the plan and were allowed to intervene and file briefs on the question. On September 24, 1941, the Commission rejected the management's objections and issued its supplemental findings, opinion and order approving the final plan as amended. On November 7, 1941, the Commission was notified that the plan had been consummated. (R. 145.)

* The intervening members of Federal's management voted their stock against the plan in order to protect their rights in the event they should obtain reversal of the Commission's order in judicial review proceedings. They agreed to surrender their stock in the event they should finally lose their review proceedings, and agreed to accept new stock on the same basis as public preferred stockholders if they won, this in lieu of rights to appraisal under Delaware law.

(b) *The First Review Proceeding.*—Following the Commission's approval of the final plan, as amended, the intervening members of Federal's management (the respondents in case No. 81) filed a petition for review of the Commission's order in the Court of Appeals for the District of Columbia under Section 24 (a) of the Holding Company Act. That court, with one Justice dissenting, reversed the Commission's decision with respect to the requirement that the plan accord only limited participation for the preferred shares acquired by Federal's management during the course of the reorganization (128 F. 2d 303 (1942)).

On writ of certiorari this Court expressed disagreement with some of the views of the Court of Appeals but disagreed also with the reasoning on which the Commission had based its conclusion. This Court neither reversed nor affirmed the decision of the Court of Appeals, but remanded the case to that Court with directions to remand it to the Commission for such further proceedings not inconsistent with this Court's opinion as might be appropriate (R. 98, 111).

This mandate and the accompanying opinion of this Court are the crux of the present proceeding before this Court, raising the paramount question whether the subsequent proceedings before the Commission are within the letter and spirit of this Court's decision.

(c) *Proceedings Before the Commission Following the Remand.*—After the remand of the case to the Commission by the Court of Appeals (R. 117), Federal Water & Gas Corp. (Federal Water), the surviving corporation under the plan, filed an application with the Commission for approval of an amendment to the plan to provide for issuance of new common stock of the reorganized company for distribution to the members of Federal's management in respect of the shares of old preferred stock which they had acquired during the course of the reorganization (R. 118). Such new stock was to be issued and distributed to the management *pari passu* with that previously distributed to the public investors. The intervening members of the management joined with Federal Water in asking that this proposed amendment be approved (R. 127). The staff and a holder of common stock of Federal Water who had previously held Federal's class A stock opposed the amendment. Following briefs and oral argument the Commission on April 17, 1944, issued findings, opinion and order denying the application (R. 130). Objections were made thereto and the Commission decided to reopen the proceeding for further argument and suspended the effectiveness of its order (R. 130). Following this further argument the Commission determined to withdraw its findings and opinion of April 17, 1944, and substituted in place thereof its findings, opinion and order of February 7, 1945 (R. 128).

This is the order now under review. Like the withdrawn order of April 17, 1944, it denied the application to amend the plan so as to accord parity of treatment to the preferred stock purchased by the management.

(d) *Judicial Review of Commission's Current Order.*—Federal Water and the members of Federal's management affected by the Commission's order of February 7, 1945, filed separate petitions for review in the Court of Appeals for the District of Columbia (B. 2, 14).^{*} Proceedings in that court were consolidated for record, briefs and argument (R. 183–184). On review the Court of Appeals reversed the Commission's order (R. 172–180).

SPECIFICATION OF ERRORS

The court below erred:

1. In holding that this Court's prior decision precluded the Commission from denying to the

^{*} Since this case was properly before the court below on the petition of the members of the management who are interested in setting aside the Commission's order, the Commission noted, but did not argue, the question whether Federal Water has standing to file a petition for review as a "person or party aggrieved" by the Commission's order, within the meaning of Section 24 (a) of the Holding Company Act. Federal Water's financial interest would be advanced by sustaining rather than upsetting the order. In the previous review proceedings Federal Water intervened, but did not petition for review. The difference between that case and the present one is that our previous order *approved* a plan submitted by Federal with amendments to conform to the Commission's views; here the order under review *disapproved* Federal Water's proposed amendment to the otherwise completely consummated plan.

preferred stock acquired by Federal's management during the course of the reorganization proceeding, participation in the plan on a parity with publicly held preferred stock.

2. In holding that this Court's prior decision precluded the Commission from resting its order denying parity participation for the management-acquired preferred stock upon the Commission's reorganization experience in the light of the undisputed facts in the record and its conclusions of at least potential harms to investors and to the integrity of the reorganization process flowing from the management's purchase program.

3. In holding that this Court's prior decision allowed the Commission to cope with the problem of management trading during the course of a reorganization under the Act solely by general rule, presumably of only prospective application.

4. In substituting the court's judgment and rejecting the judgment of the Commission as to the probabilities of harm to investors and the reorganization process from the stock purchase program of Federal's management.

5. In reversing the Commission's order of February-7, 1945.

SUMMARY OF ARGUMENT

I. The Commission's order is fully authorized by the mandate of this Court in *S. E. C. v. Chenery Corporation, et al.*, 318 U. S. 80. The decision of the court below to the contrary is based

upon a partial reading of this Court's opinion. Read as a whole, this Court's opinion merely held that the Commission's original order was not supported by the equity precedents on which the Commission had relied, and that the Commission's determination could not be sustained as an exercise of administrative judgment because the Commission's opinion did not set forth the findings and considerations which would justify its order as an appropriate safeguard for the interests protected by the Act. This Court did not hold intrinsically unsound the argument presented in the Commission's brief for upholding the Commission's order as an exercise of administrative judgment. It deemed this argument inapplicable because not consistent with its understanding of the Commission's opinion. References in the Court's opinion to the Commission's power to deal by a general rule with the problem of management trading during a reorganization under the Act, are, contrary to the decision of the court below, merely illustrative. Other language in the opinion, wholly ignored by respondents and the court below, clearly shows that this Court did not intend to prohibit the Commission from developing an applicable standard of conduct on a case-by-case basis. Our interpretation of the meaning of this Court's mandate and opinion is further supported by a study of the language of the mandate itself, in comparison with the previous opinion and order of the court below.

II. The Commission's present order is fully supported by substantial evidence in the record, as recited in the Commission's findings and opinion. The Commission has now made the findings and disclosed the considerations which it had previously *argued* to this Court as grounds for upholding its original order. The Commission, as an administrative agency expert in problems of reorganization under the Holding Company Act and other statutes, was fully entitled to resort to its administrative experience in interpreting the facts of this case and in drawing its conclusions about those facts. The view of the court below and respondents that the Commission was not permitted to integrate its special experience with the evidence, and the determination of the court below to substitute its different judgment and experience for that of the Commission in its present findings and opinion, are contrary to the well-settled principle that courts will not undertake to substitute their judgment for that of the agency unless there is no rational basis for the agency's determination.

In this case the Commission's findings and opinion exhibit a firm rational foundation for the Commission's order. It viewed the management's stock purchase program in the light of the broad powers of a holding company management under the Act, including its control over the financial, operating and accounting policies of the various companies in the holding company system, and its

power to initiate and shape reorganization proceedings under Section 11 (e). It observed that entering upon such a purchase program creates a harmful conflict of interest because of the resulting temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices, and because of the impossibility of giving public security holders, to whom the management owed a fiduciary responsibility, the equivalent of the management's insight into the future course of the reorganization. For these reasons the Commission concluded that it could not, consistently with the fair and equitable and other applicable standards, permit the management to realize their expected advantages from the purchase program, in terms of profit and control.

III. The lower court's conclusion that the Commission could deal with the problem of management trading during the course of a reorganization under the Act only by general rule, presumably operating prospectively, is, in essence, a criticism of the Commission's present order as improperly retroactive. That determination is an oblique attack upon the meaning of this Court's mandate and opinion, which imposed no trammels on the Commission's powers and fully authorized the Commission to reach the result it has reached upon a clear and explicit statement of the administrative reasons justifying that result. As courts and legislatures have long perceived, standards of con-

duct for fiduciaries may properly be established on a case-by-case basis in which liability is necessarily determined after the event. Any other procedure would place a premium on new methods of evading previously announced standards. This Court has been highly cognizant of the need for administrative agencies to deal on a case-by-case basis with novel and complex problems. Here the Commission's order merely denies to petitioners a hoped-for profit on their investment, a result which is necessary if the plan of reorganization is to be affirmatively found fair and equitable and not detrimental to the interests of investors, as required by the Act.

ARGUMENT

I.

THE COMMISSION'S PRESENT ORDER CONFORMS TO THE PRIOR MANDATE OF THIS COURT

The Commission, the court below (R. 174), Federal Water, and Federal's management all agree that the basic issue in this case is whether the Commission's findings, opinion and order of February 7, 1945, are consistent with the decision of this Court in *S. E. C. v. Chenery Corporation, et al.*, 318 U. S. 80. In issuing its present order the Commission construed this Court's opinion and mandate as holding that the Commission's original order, judged solely upon the grounds of judicial equity relied on by the Commission, could not be sustained because the equity decisions upon

which the Commission had relied did not support the interpretation placed on them by the Commission. The Commission accepted this Court's declaration that it was "not imposing any trammels on" the Commission's powers in reexamining the case upon the remand. The Commission understood this Court as holding further that the Commission had broad statutory powers to protect the public against reorganization abuses, and that upon the remand the Commission was free to consider whether, in the light of the Commission's special experience in administering the legislative policies of the Holding Company Act, the trading by Federal's management during the course of the reorganization proceeding created risks of harm to public investors which would warrant a requirement of special treatment for the management-acquired stock designed to prevent the management from profiting from such purchases.

The respondents and the court below construed this Court's opinion and mandate to mean that, absent findings of conscious wrongdoing on the part of Federal's management, the Commission was not authorized to determine by order in the particular case whether it was consistent with the applicable standards of the Act to permit Federal's management to realize a profit through their reorganization purchases. In their view, and on the hypothesis that the Commission could not,

or would not, find fraud or other conscious wrongdoing, the only permissible disposition of this case was a Commission order which would permit Federal's management to realize their anticipated profit—although the Commission might perhaps be free to promulgate a general rule of solely prospective operation which would preclude realization of such profits in future cases.

We set forth below specific references to this Court's opinion which we believe fully support the Commission's interpretation and are wholly inconsistent with that of respondents and of the court below.

A. The starting point of this Court's reasoning is a statement of complete accord with what had been the Commission's major premise, that "officers and directors" of a company in process of reorganization occupy positions of trust. The Court also stated that a "lax view of fiduciary obligations" would not be countenanced. The conclusion that Federal's management were fiduciaries was stated only to begin analysis of the extent of their fiduciary obligations and the consequences of deviation therefrom. (R. 102; 318 U. S. 85-86.)

B. The Commission's opinion was interpreted as predicated upon a rule of law derived from equity precedents (R. 102-104, 106; 318 U. S. 87, 90), and it was held that review would be confined to the grounds upon which the Commission acted, since

If an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service for an administrative judgment. For purposes of affirming no less than reversing its orders, an appellate court cannot intrude upon the domain which Congress has exclusively entrusted to an administrative agency. (R. 104-105; 318 U. S. 88.)

C. The opinion then holds—

If, therefore, the rule applied by the Commission is to be judged solely on the basis of its adherence to principles of equity derived from judicial decisions, its order plainly cannot stand. (R. 105; 318 U. S. 88.)

Distinguishing on their facts the authorities relied on by the Commission, the Court concluded "that the Commission was in error in deeming its action controlled by established judicial principles," noting nonetheless that

Determination of what is "fair and equitable" calls for the application of ethical standards to particular sets of facts. But these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time

the Public Utility Holding Company Act of 1935 became law. (R. 105-106; 318 U. S. 89.)

D. The Government had argued that the Commission acted properly and within the purview of its administrative competence because management trading can affect "the timing and dynamics of the reorganization which the management itself initiates and so largely controls." The Court examined this argument in the light of the applicable standards of Section 7 (d) (6) and (e) and Section 11 (e) of the Act and the intimations in the legislative history that Congress intended by these standards to enable the Commission to afford a higher decree of protection to public security holders than had theretofore prevailed in connection with reorganizations (R. 107; 318 U. S. 90). In the light of these standards and the fact that the Act "vests in the officers and directors of a holding company registered under the Act broad powers as representatives of all the stockholders," the Court concluded that "notwithstanding § 17 (a) and (b), therefore, the Commission could take appropriate action for the correction of reorganization abuses found to be 'detrimental * * *'" in the light of "those more subtle factors in the marketing of utility company securities" which induced the evils the Act was designed to correct. (R. 107-108; 318 U. S. 90-92.)

Thus far in the Court's opinion there is no reference to the Commission's rule-making power,

and no intimation that the Court was discussing anything except the proper disposition by the Commission of the pending case. In construing the opinion to mean that the Commission was not free after the remand to consider a disposition, based on statutory standards, which would prevent Federal's management from realizing its anticipated profits, we submit that respondents and the court below have made what the Court has said up to this point largely meaningless.

E. Respondents and the court below predicate their interpretation upon certain references to the Commission's rule-making power which this Court mentioned in examining the Commission's decision in the light of the broad powers which it had concluded to be vested in the Commission. This Court said "that the considerations urged here in support of the Commission's order were not those upon which its action was based," and observed that the Commission had "formulated no judgment upon the requirements of the 'public interest or the interest of investors or consumers' in the situation before it" (R. 108-109; 318 U. S. 92-93). It was in this context that the Court pointed out that an entirely different problem would have been presented "had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application * * *". Nor has the Commission, acting under the rule-making powers delegated to it by § 11 (e), pro-

mulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity." (R. 108-109; 318 U. S. 92-93.)

Neither of these references to the Commission's rule-making power purports to indicate that the Commission could deal with the problem of management trading in the course of a reorganization solely by an exercise of its rule-making power. To read such a meaning into these statements not only ignores practically all of the Court's preceding analysis of the Commission's powers under the Act, as well as the direct context of the Court's remarks, but assumes that the Court, with the provisions of Section 11 (e) of the Act before it, was unaware that the first sentence of this section authorizes the Commission to supervise by *order* as well as by rules and regulations the conditions under which plans are proposed, and that, indeed, under the second sentence the Commission may determine whether a plan is fair and equitable only by *order*.¹⁰ Accordingly, we submit that this Court could not have intended to prevent the Commission from deciding this specific case after the remand on the basis of its general ad-

¹⁰ The fact that Section 11 (e) requires the Commission to determine by order whether a plan is fair and equitable and that such determination, as this Court noted "calls for the application of ethical standards to particular sets of facts," means that this Court was not then faced with the problem which later divided it in *Addison v. Holly Hills Fruit Products, Inc.*, 322 U. S. 607, as to the propriety of

ministrative experience evolved and applied in the case-by-case procedure clearly contemplated by Section 11 (e).¹¹

Corroboration of the Commission's interpretation of this Court's references to the Commission's rule-making powers is found, we submit, in the concluding paragraphs of the opinion (R. 110-11; 318 U. S. 93-95)—paragraphs which respondents and the court below have wholly ignored. In these paragraphs this Court restated its conclusion¹² that the Commission's original order could not be upheld on the basis of judge-made rules of equity, and declared that the Court could not assume for itself the Commission's duty of determining whether the management's activities were detrimental to investor interests or unfair and inequitable in contravention of the standards of Sections 7 and 11 of the Act. Speaking negatively—because the Commission had not stated the necessary findings and considerations—this Court indicated that the

remanding a case for consideration by the agency of the desirability of adopting a rule operative retroactively in an area in which the agency is limited to acting by rule. See *infra* p. 51 *et seq.*

¹¹ Compare *F. C. C. v. Pottsville Broadcasting Co.*, 309 U. S. 134, 145:

"On review the court may thus correct errors of law and on remand the Commission is bound to act upon the correction. * * * But an administrative determination in which is imbedded a legal question open to judicial review does not impliedly foreclose the administrative agency, after its error has been corrected, from enforcing the legislative policy committed to its charge."

Commission's order might have been upheld if findings had been made and considerations disclosed "which would justify its order as an appropriate safeguard for the interests protected by the Act." Thereafter, in the penultimate paragraph of its opinion, this Court declared that the basis of its action was to correct the Commission's misconception of the law and to require, in the interests of the orderly functioning of the process of review, that "the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained" (R. 110-111; 318 U. S. 94-95). Citing and quoting from *Phelps Dodge Corp. v. Labor Board*, 313 U. S. 177, 197, language which was stated to be "equally applicable here," this Court declared that it did "not intend to enter the province that belongs to the" Commission and that "all we ask of the [Commission] is to give clear indication that it has exercised the discretion with which Congress has empowered it. This is to affirm most emphatically the authority of the" Commission. Further stressing the limited extent of its decision and the broad powers intended to be left to the Commission upon the remand, this Court stated (R. 111; 318 U. S. 95):

In finding that the Commission's order cannot be sustained, we are not imposing any trammels on its powers. We are not enforcing formal requirements. We are not suggesting that the Commission must justify its exercise of administrative discretion in any particular manner or with

artistic refinement. We are not sticking in the bark of words. We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.

These concluding words, of this Court are, as we see it, completely robbed of meaning if the view of the respondents and the court below were to obtain. On their theory the mandate of this Court was in substance merely an affirmance upon different grounds of the lower court's original decision, which had plainly left the Commission no recourse but to allow Federal's management to participate equally with all other stockholders with respect to the preferred stock acquired by the management during the reorganization proceeding. But it is clear that this Court's mandate was not one of affirmance of the Court of Appeals. On the contrary, this Court directed the Court of Appeals to remand the case to the Commission "for such further proceedings, not inconsistent with this opinion, as may be appropriate." (R. 111; 318 U. S. 95.) Such a mandate, we submit, was in harmony only with an opinion which, having corrected errors of law on the part of the Commission, but disagreeing with the earlier ruling of the Court of Appeals that the Commission was required to accord parity treatment to the management holdings of preferred stock, sent the case back to the Commission

for reexamination as an exercise of administrative judgment.

II

THE COMMISSION'S PRESENT FINDINGS AND OPINION DISCLOSE A RATIONAL AND COMPETENT EXERCISE OF ITS ADMINISTRATIVE DISCRETION IN THE APPLICATION OF THE STATUTORY STANDARDS

In its present findings and opinion the Commission has amplified the administrative considerations which had been presented to this Court in the Commission's brief and argument in the first *Chenery* case, and which this Court had held not then relevant because not constituting the disclosed basis for the Commission's original decision. The Commission's present decision makes clear that its basis is the relation of management trading to the timing and dynamics of the reorganization which the management itself initiates and so largely controls"; the "strategic position enjoyed by the management in this type of reorganization proceeding"; the circumstance that in such a reorganization proceeding there is vested in the management "statutory powers available to no other representative of security holders"; the "more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Company Act of 1935 was designed to correct"; and questions as to "abuse of corporate position, influence, and access to information * * * so subtle that the law can deal with them effectively only by prohibitions not con-

cerned with the fairness of a particular transaction." (318 U. S. at 90, 92, R. 106, 108, 109.) In its present findings and opinion the Commission has stated that it has derived its conclusions on these matters from the facts of this case and from its general experience in dealing extensively with corporate reorganizations, both under the Act, and other statutes entrusted to it, and from its exhaustive studies of protective and reorganization committees. In short, as an examination of the Commission's present findings and opinion will disclose, the Commission has now made the findings and disclosed the considerations which this Court previously indicated "would justify its order as an appropriate safeguard for the interests protected by the Act." No question is made as to the substantiality of the evidence to support the Commission's subsidiary findings of fact. Indeed, they are based upon undisputed facts. There remains only the question of whether there is a rational basis in law for the Commission's conclusions. Because the opinion of the court below does not, as we see it, adequately set forth the present rationale of the Commission, we call this Court's attention to certain salient aspects thereof.

First, it must be noted that the Commission carefully circumscribed the precise question before it by stripping away "the more general legal question whether corporate managers normally are entitled to realize whatever advan-

tages they may seek by trading in the stock of the corporation they manage" (R. 147), and by indicating the sharp distinction between managerial purchases "while corporate operations were taking their normal course" from those made during the "critical period while the corporation and its subsidiaries were undergoing necessary structural changes" (R. 148). The narrow question left for decision was whether (R. 146)—

* * * on the record before us it would be consistent with the purposes and standards of the Holding Company Act for us to approve the amended plan as the means by which the interveners may realize the increment, in terms of profit and control, that they expected would accrue to them through their acquisition of preferred shares while this reorganization was under consideration.

In passing upon the plan, the Commission indicated that it was required to determine (1) whether the plan was "fair and equitable" to the persons affected thereby within the meaning of Section 11 (e); (2) whether the terms of the new stock issuance were "detrimental to the public interest or the interests of investors or consumers" under Section 7 (d) (6); (3) and whether the proposed alteration of rights of Federal's security holders would "result in an unfair or inequitable distribution of voting power" or "be detrimental to the public interest or the interest of investors or consumers" within the meaning of

Section 7 (e) (R. 147). It was the Commission's view that positive affirmative findings were required under each of these sections and that with respect to the first question, "if the record leads us to a negative answer, or leaves undisputed doubts generated by any step taken by the management in the reorganization process, we cannot in good conscience make the affirmative finding required to sustain our approval and must accordingly withhold such approval, even if we made no affirmative finding" regarding the second and third questions (R. 147-148).

The Commission's conclusion (R. 149) was that it was unable to find that the plan, as proposed to be amended to allow participation for the management-acquired preferred stock on a parity with publicly held stock, would be "fair and equitable" within the meaning of Section 11 (e). Stated affirmatively it concluded that the plan, if amended, would be "detrimental to the public interest and the interests of investors" and would result in an unfair and inequitable distribution of voting power contrary to the requirements of Sections 7 (d) (6) and 7 (e). The Commission declared itself led to this result by the character of the conflicting interests created by the management's program of stock purchases carried out while plans of reorganization were under consideration.¹² The Commission therefore refrained

¹² "Doubts, inevitably suggested by the existence of these conflicting interests, remain unresolved * * * (R. 149.)

from making the required affirmative statutory findings of approval.

As reasons for its conclusions, the Commission first pointed out the powers of a holding company management in a voluntary reorganization under Section 11 (e), contrasting the management's functions in that mode of reorganization with those of a management in a Chapter X reorganization where an independent trustee has been appointed to control, under the aegis of the court, the supervision of the business and the framing of the plan of reorganization (R. 152). In view of the management's preeminent powers in a reorganization under Section 11 (e) of the Holding Company Act, bearing in mind all of the management's stake in securities, compensation, and other perquisites of both profit and prestige, the Commission deemed it necessary to exercise fully for the protection of investors the powers which Congress had given it to supervise the reorganization process in order to eliminate detrimental practices in reorganization and, in the words of the committee report, to "make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even, as is often the case, majorities." S. Rep. No. 621, 74th Cong. 1st Sess. p. 33 (R. 152).

The Commission found that Federal's management controlled a large multi-state utility system and in that system occupied over a hundred

directorships, 35 presidencies, 25 vice presidencies, and six treasurerships, that one member of the management was chairman of the boards of 11 companies, that one of them was general counsel for 17 companies, and that a third was a consulting engineer for 16 companies. With respect to Federal itself, the Commission found that the present individual respondents before this Court included three directors, the president, six vice presidents, the secretary and the treasurer. (R. 153.) Permeating the entire system in this way, Federal's management could obviously, in the normal course of operations, influence the entire system down to the lowest tier of operating companies. Through their control over the financial, operational, and accounting policies of the parent and its subsidiaries, they determined whether and when subsidiary earnings should be drawn up into the holding company or withheld, and it was possible for them to obscure earnings within the accounts of the subsidiaries. (R. 153.) The Commission found that exercise of such powers can affect the corporate income of the holding company, can reduce or increase an impairment of capital, and ultimately can affect the holding company's ability to pay dividends. Furthermore, such activities, coupled with control of timing and presentation of plans, can affect the market prices of the holding company's outstanding securities among the various classes of security holders and even their respective participations in a reorgan-

ization under the Act. (R. 153-154.)¹⁵ The Commission pointed out that the broad range of business judgments vested in a holding company's management—because of the pyramided nature of the enterprise—multiplied opportunities for manipulation and made the exercise of judgment on any matter a subject of greatest significance to investors (R. 154-155).

The Commission also referred to the control of the holding company management over refinancing of subsidiaries in the sale and rearrangement of subsidiary properties, frequently having substantial effect upon the flow of earnings to the top company (R. 155). The Commission commented upon some of the subsidiary reorganizations, refinancings and transfers in the Federal system which were taking place during the course of the reorganization of Federal and which indicated "the far-reaching functions of the holding-company management during the reorganization period." The Commission pointed out further that certain of the subsidiary rearrangements necessarily affected its consideration and determination of the fairness of Federal's plan. (R. 140-41.)

Added to all these corporate managerial powers,

¹⁵ Such determinations are based largely on earnings records, and those records may be affected by management decisions whose manipulative intent often cannot be discovered without an investigation into the state of the management's mind (R. 153-154, 160-161.)

the Commission found, as this Court had previously pointed out, that a holding company management obtained special powers in the course of a voluntary reorganization under Section 11 (e) of the Holding Company Act (R. 155; 318 U. S. 80, 91). These special powers derived in part from the circumstance that under Section 11 (e) the management was representative of all the stockholders, initiated the proceeding, drew up and filed the plan, and could file amendments thereto at any time. Because of its representative status the management had special opportunities to obtain advance information of the attitude which the Commission's staff might take as to pending plans or future proposals when such plans should be brought before the Commission (R. 156).

The Commission's experience indicated to it that all these normal and special powers of the holding company management during the course of the reorganization under Section 11 (e) placed in the management's command "a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute." (R. 156.) It was in such a setting that the Commission was required to consider the hazard of a managerial program of purchasing stock

for profit and control purposes during the course of the reorganization proceeding."

As the Commission stated, "If, in this setting, the management enters upon a stock purchase program there is inevitably the temptation, as well as the opportunity, to shape the reorganization proceeding so as to encourage public selling on the market at low prices. Public announcements by

¹⁴ The Commission recognized of course that conflicts of interest might often prevail between management and one or more classes of its security holders, where, as frequently is the case, the management predominantly represents the interests of one class, usually the common stockholders who normally elect the management to office and in which class the management often itself has a financial interest. But that conflict, the Commission pointed out, was a normal and unavoidable attribute of any extra-judicial reorganization where the plan was not formulated by an independent representative of all classes. In consequence, that conflict could be anticipated. (R. 157.)

It was the Commission's view, however, that the conflict ceased to be normal or unavoidable when members of the management undertook to obtain personal advantage out of the reorganization by engaging in a program of buying its outstanding securities for the purpose of obtaining either voting power or an enhanced value which the management expected those securities to have in the reorganized corporation. At that point, the Commission declared, "any management, no matter how honorable, makes its own motives suspect. Indeed, once it enters upon such a program even its acts prior to reorganization are compromised in retrospect because for all practical purposes it is impossible for anyone, attempting at a later time to trace back and sort out the motives that guided such action, to reach a firm conclusion that managerial judgment was not in at least some respects exercised in contemplation of the personal gain to be realized ultimately from the reorganization." (R. 157-58.)

the management can be directed to that end. Steps can be taken that may delay and protract the proceedings in such a manner as to make senior stockholders lose hope of receiving dividends within a reasonable time and induce some of them to sell out at a sacrifice."¹⁵

No management, the Commission found, could engage in such a program without raising serious question as to whether its personal interests had not opposed its duties "to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously." The natural in-

¹⁵ The Commission noted that "many unsupervised reorganizations have been accomplished by first stopping dividends and starving the non-voting preferred stock to the point of desperation, then wielding the voting power of the junior stock as a weapon to force ultimate reorganization on terms unduly favorable to the latter. The management of a holding company is in a peculiarly strategic position to know the meaning of the non-payment of dividends, and what can be done to remove blocks in the flow of earnings from subsidiaries." (R. 156, note 24.)

¹⁶ The management's determination to withdraw the Third Plan because of *Havender v. Federal United Corporation*, 6 A. 2d 618 (Del. Ch. 1939) and its determination not to attempt to put through a plan in a federal court proceeding under Section 11 (e), thereby overriding the state law restriction presented by the *Havender* case, illustrate the broad powers exercised by Federal's management as reorganization managers (R. 65-66, 136). We do not say they were improper decisions; we cite them solely as examples of powers actually used. The testimony of Mr. C. T. Chenery

clination of any person to buy cheaply, coupled with the normal and extraordinary powers of a holding-company management to further that objective by creating the conditions which make cheap buying possible during the course of a reorganization before us, are bound to create a risk—perhaps in some cases merely potential but in all cases very real—of harm to all of the company's public security holders whether or not they elect to sell." (R. 158.)

If there were proof that reorganization managers had engaged in such a program of buying in the stock at bargain prices intentionally created or maintained by their own acts, the Commission could not properly find a plan fair and equitable which allowed the managers to retain those inequitably obtained benefits. It was the Commission's view, however, that the answer should not be substantially different even though proof of intentional wrongdoing was lacking in a particular case. The construction of normal powers and unique powers under Section 11 enjoyed by Federal's management in the operation of the system, and the ways in which such powers were exercisable led the Commission to conclude that "absence of unfairness or detriment in cases of this sort would be practically impossible to

quoted in the Commission's opinion shows that the management acted with full understanding of its power to make litigation an alternative to negotiation (R. 143).

establish by proof. * * * Questionable transactions may be explained away, and an abuse of investors and the administrative process may be perpetrated without evil intent, yet the injury will remain." (R. 161.)

Turning then to the record in the present case, the Commission pointed out that the salient fact was that Federal's management had as its primary object in buying the preferred stock "the voting power that was accruing to that stock through the reorganization, and * * * profit from their investment therein" (R. 161). That stock, the Commission observed, had been purchased in the market at prices which were depressed in relation to what the management anticipated would be, and what in fact was, the earning and asset value of its reorganization equivalent. Considering the management's justification of its motives in operating the business of the system and formulating the plans of reorganization, the Commission concluded that the management was merely endeavoring to "deny that they made selfish use of their powers during the period when their conflict of interest, *vis-a-vis* public investors, was in existence owing to their purchase program." (R. 163.) Further, it was the Commission's opinion that Federal's management, having undertaken this program, had placed itself in a position where it was "peculiarly susceptible to temptation to conduct the reorganiza-

tion for personal gain rather than the public good," and, consequently, that program insofar as it depended upon making *advantageous* purchases of stock "could have had an important influence—even though subconsciously—upon great numbers of business decisions all along the way" (R. 163).

Considering the management's necessarily superior knowledge, the Commission concluded further that it was not possible, as a practical matter, for management to give the stockholders generally enough of that superior knowledge to enable the stockholders to form an independent judgment on the question whether or not they should sell and at what price.¹⁷ For this reason, said the Commission, the traditional concepts of "honesty, full disclosure and purchase at a fair price" could not be the controlling tests, however controlling they might be when applied by courts to dealings in normal course between corporate managers and stockholders (R. 164).¹⁸ Those

¹⁷ The management, after all, was under a fiduciary duty in the reorganization to represent all the company's stockholders, including those from whom the managers were purchasing stock.

¹⁸ The Commission in its present opinion has explained the wholly argumentative meaning which it had intended to convey by the so-called "admissions" of fair dealing on the part of Federal's managers, as referred to in this Court's prior opinion (R. 164). What the Commission meant in its original opinion, and what its counsel in briefs and argument upon review had assumed, was merely that the inflex-

tests could not be determinative of the Commission's problem, "which is to be fully satisfied that the plan of reorganization is fair and equitable, and not detrimental in the particular circumstances bearing upon the acquired stock *vis-a-vis* the stock of public investors."^{18a}

Thus the Commission rested not only on the ground that undiscoverable abuse may have occurred, but that, in some respects, abuse was in-

ible rule of equity on which it originally relied did not even permit inquiry into the question whether the transactions of the reorganization managers here were characterized by "honesty, full disclosure and purchase at a fair price."

It should be noted that the opinion of the court below not only ignores the Commission's explanation of why it actually made no findings whatever on the subject of the good or bad faith of Federal's managers, but instead emphasizes again and again, without any foundation in the record, what it terms affirmative findings that "petitioners' purchases of stock were in all respects fair, honest and aboveboard, resulting neither in an unjust enrichment to themselves nor harm to other stockholders or the public" (R. 174), and that "the result was neither unfair nor inequitable to the persons affected by the plan" (R. 174). See R. 174-177. The Commission has made no such findings.

^{18a} As this Court declared in *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, 543:

"It is * * * wrong to fetter the Board's discretion by compelling it to observe conventional common law or chancery principles in fashioning such an order, or to force it to inquire into the amount of damages actually sustained. Whether and to what extent such matters should be considered is a complex problem for the Board to decide in the light of its administrative experience and knowledge." (*Italics supplied.*)

evitable as a result of the purchase program. In this category, for example, belongs the Commission's conclusion that full disclosure to selling stockholders would require the management to do the impossible job of bringing the investor up to its own level of sophistication and knowledge about the system, the course of internal negotiations, the attitude of the staff and the future intentions of the management (R. 163).¹⁹

The respondents have not challenged either the facts in the record or the validity of the conclusions which the Commission drew from its general experience in administering the Act. The court below, however, objected to the Commission's use of its administrative experience by describing the Commission's judgment as to the probability of harm to investors without proof of

¹⁹ Obviously the extensive negotiations between Federal management and the staff which occurred in the instant case gave the management an insight beyond that available to the public preferred stockholders to whom the management owed fiduciary obligations but from whom it was purchasing stock. For example, the management would have realized that any plan which would meet Commission approval would probably require denial of participation to the B stock and would accord a more valuable participation to the preferred stock than reflected in the earlier proposal of the management. Yet public security holders may well have looked to management proposals as an indication of the participation they might expect. The management possessed similar advantages of inside information arising out of negotiations with the staff with respect to the relative participation of the preferred stock which the management was purchasing and the class A stock in which the management had no interest.

wrongdoing in the particular case as a "rule of fiat" and as a decision based upon "an unsupported suspicion," "unresolved doubt," and "weaknesses or selfishness which the Commission believes is inherent in human nature." (R. 178-179.) We submit, however, that there was substantial evidence to support the Commission's decision in the undisputed facts and that the Commission could properly view this evidence from the vantage point of its special experience with reorganization abuses. Indeed, the Commission's failure to base its original decision upon such administrative considerations seems to have been a motivating factor in this Court's first opinion.

The Commission was entitled to conclude from its experience that the management's persistent efforts to obtain participation for the worthless Class B stock; its attempts to salvage some control through the device of electing directors to staggered terms, and its purchases of preferred stock at depressed prices for the admitted purpose of preserving its control over Federal and its system, as well as in the expectation of profits through the plan, created hazards harmful to investors and to the integrity of the reorganization process. Similarly, the Commission was not bound to infer from the management's post-hoc testimony that the conflicting interests so created had not in fact affected its judgment as to the proper exercise of its broad powers over the reorganization and that no harm had in fact resulted.

In insisting that the Commission could not rely upon its administrative experience the court below was in essence making respondents' difficulty of controverting, in the review proceedings, the Commission's administrative judgment a ground for precluding the exercise of that judgment (R. 178-179). In so holding the court below overlooked, however, this Court's prior intimation that "abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." (R. 109; 318 U. S. 92.) In addition, this criticism by the court below and the respondents represents the same groundless attack upon the Commission's powers which this Court rejected in the analogous case of *Republic Aviation Corp. v. N. L. R. B.*, 324 U. S. 793. There, it will be recalled, the order of the Labor Board holding improper discharges of employees for solicitation of union membership in violation of the employers' non-soliciting rule was decided by the Labor Board as a case to which general considerations evolved from its administrative experience were fully applicable.²⁰ The argument of the employer, like that used by the court below in

²⁰ The quotations from the Labor Board's opinion which appear as footnotes to this Court's opinion in the *Republic Aviation* case show a marked similarity of approach to that adopted by the Commission in the present case.

reversing the Commission's present order, was that the Board could not use its knowledge of industrial relations in lieu of proof of conscious wrongdoing in the particular case. As this Court declared, in rejecting that contention, "One of the purposes which led to the creation of such boards is to have decisions based upon evidential facts under the particular statute made by experienced officials with an adequate appreciation of the complexities of the subject which is entrusted to their administration." (324 U. S. at 800.)

What the court below lost sight of in its condemnation of the Commission's decision is that there was ample room for judicial review of the Commission's findings in the present case—or would have been if respondents had seriously challenged either the substantiality of the evidence, so far as the findings of fact are concerned, or "the rationality between what is proved and what is inferred." See *Republic Aviation Corp. v. N. L. R. B.*, 324 U. S. 793, 805. See also *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, 543.

The Commission's duty to apply to the facts of this case conclusions drawn from its broad administrative experience comes close to the heart of the whole administrative process and reflects one of the chief reasons for the creation of administrative agencies. This Court in its earlier opinion recognized the special experience

of the Commission in the reorganization field (R. 108; 318 U. S. 92).²¹

While respondents have not challenged the appropriateness of the Commission's choice of remedy insofar as limiting the management to cost plus four per cent interest with respect to the stock acquired during the course of the reorganization, we believe we should point out that the remedy chosen was similar to that adopted by Congress in Section 17 (b) of the Holding Company Act and Section 16 (b) of the Securities Exchange Act. These provisions allow corpora-

²¹ That the Commission had the background requisite to exploring the problem in this case and to form a seasoned judgment about it is evident not only from the Commission's experience in administering the Holding Company Act but, as well, from its contact with reorganization problems generally, in the performance of its duties under Chapter X of the Bankruptcy Act and under the Investment Company Act and in conducting the investigations and studies reported to Congress in the protective committees report and the investment companies report. See Bankruptcy Act of 1938, §§ 172, 179, 190, 208, 222, 247, 265a (11 U. S. C. §§ 572, et seq.); Investment Company Act of 1940, § 36 (15 U. S. C. § 80a-35); S. E. C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937-1940), Parts I-VIII; Report of the S. E. C. on Investment Trusts and Investment Companies (1938-1942), Parts 1-5. It was in view of the Commission's unique experience in the reorganization field that this Court declared in its prior decision that the Commission "accumulates an experience and insight denied to others" and that the Commission's administrative determination "must not be set aside because the reviewing court might have made a different determination were it empowered to do so."

tions to recover management profits from short-term trading in the corporate securities. It is likewise the remedy adopted by Congress in Section 212 of Chapter X of the Bankruptcy Act for the purpose of preventing reorganization managers under the Act from profiting from security transactions during the course of a reorganization thereunder. See S. Rep. No. 1916, 75th Cong., 3rd Sess., pages 33-34. Furthermore, the question of the appropriate remedy, like the problem of what formal inferences are to be drawn on the basis of admitted facts, is one on which this Court has held that the administrative judgment must stand unless clearly erroneous. See *Phelps Dodge Corp. v. N. L. R. B.*, 313 U. S. 177, 194-95; *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, 539-43; cf. *Gemsco v. Walling*, 324 U. S. 244.

III

THE COMMISSION WAS ENTITLED TO FORMULATE THE STANDARD APPLIED IN THIS CASE BY ORDER AND WAS NOT LIMITED TO ACTING BY A GENERAL RULE

In passing on Federal's plan the Commission was dealing with a particular case involving a particular plan which could be passed upon only by *order* and only after the Commission had determined whether, in that case, it could or could not find that plan "fair and equitable." No general rule of any type whatever could have avoided the necessity for acting by order in relating that

rule to the facts of the particular case. Since the only benefit which the respondents could have obtained from a pre-existing general rule would have been *foreknowledge* that their purchases might ultimately be held improper, the only consequence of the absence of such a rule in the decision of this case is to raise a question of possibly improper retroactivity. It is a question of retroactivity which lies at the base of the lower court's holding that the Commission, in dealing with the problem of management trading in a voluntary reorganization under the Act, could rely on its administrative experience only in the formulation of a general rule. (R. 175, 179, 180.)

Of course some element of retroactivity is involved in the application of any standard, legal, equitable or ethical, to particular sets of facts. This is so whether a jury is applying a standard of due care, a court of equity is applying equitable principles governing the conduct of fiduciaries, or the Commission is giving content to the "fair and equitable" standard of the Holding Company Act. But that kind of retroactivity, which is inherent in the Commission's present order, is not the type of retroactivity which the law condemns. Indeed, in *Phelps-Dodge Corp. v. N. L. R. B.*, 313 U. S. 177, *Republic Aviation Corp. v. N. L. R. B.*, 324 U. S. 793, and *Virginia Electric & Power Co. v. N. L. R. B.*, 319 U. S. 533, the administrative

remedies sanctioned by this Court all contained substantial elements of similar retroactivity.

The mere fact that administrative agencies, unlike courts, may have the power to lay down rules applicable to future cases as well as the power to decide particular cases before them, should not limit the agencies to the use of a rule in every case of first impression. The consequence of respondents' argument in that vein, as expressed in the lower court, would, we submit, substantially impair and, indeed, hamstring the work of every administrative agency with power to make general rules as well as specific orders. Every order not based on the letter of the statute or on all-fours with a prior decision would then be open to the novel challenge that the agency should have acted by rule, no matter how well founded was the order in the intent of the law. Such a requirement for the adoption of general rules in advance of every step forward in the agency's effectuation of statutory policies would go far to defeat the intention of Congress of promoting flexible administrative machinery for the very purpose of allowing the agencies to use varied facilities to cope with the specialized problems before them. As the Report of the Attorney General's Committee on Administrative Procedure in Government Agencies points out:²²

²² S. Doc. No. 8, 77th Cong., 1st Sess., p. 29.

* * * administrative agencies, like the courts, must often develop their jurisprudence in a piecemeal manner, through case-by-case consideration of particularized controversies. This is so partly because the full variety of circumstance can infrequently be perceived in advance. Partly, too, it is necessitated by the circumstances of the agencies' creation. Often an agency has been entrusted with responsible duties in an area in which experience is yet to be won, and where premature rigidifying of policies may prove to be harmful in the extreme. Sometimes, moreover, it is the very justification of an administrative agency's existence that it may exercise discretion in dealing with individual problems which are difficult to fit within the too inflexible boundaries of rules.

In the context of this case retroactivity is a false issue. The real area of dispute here is simply whether the specific considerations brought to bear on the issues by the Commission can fairly be said to be inherent in applying the standards and policies of the Act. If they are, we submit that there is no improper retroactivity but merely implementation of the statutory command. This court expressly found that the Holding Company Act provided a firm basis for the power employed by the Commission in this case (R. 107-108; 318 U. S. 90-92) and in so doing, we submit, eliminated any real issue of improper retroactivity.

While the first sentence of Section 11 (e) does authorize the formulation of prospective rules as well as orders, it is mandatory that the Commission act by order in determining whether a plan is "fair and equitable." Assuming for purposes of argument that the Commission should have had the foresight to formulate a rule upon the subject prior to the date of the respondents' purchases, surely that lack of foresight should not be held to obliterate its subsequent responsibility to decide this particular case in the light of applicable statutory standards. To have so concluded would, as the Commission declared, "give the intervenors a premium for risking the interests of the public investors, to the detriment of the latter, and, as well, to the detriment of investors in many other holding company securities, and of the public interest, within the meaning of Sections 7 (d) (6) and 7 (e)." (R. 166.) If holding company managements, in spite of their positions of trust in respect of pending reorganizations were free, in absence of express prohibitions, to pursue their personal advantage despite conflicting interests and risk of harm to public security holders, mere lack of foresight by the Commission would permit the "lax view of fiduciary obligations" which this Court "rejected." (R. 102; 318 U. S. 85).²³

²³ In consequence, the safeguards which Congress hoped to accomplish through "Commission approval of reorganization plans and supervision of the conditions under which such

Furthermore, as the Commission pointed out in its opinion, Federal's management was not "acting wholly in a legal vacuum" when it bought the preferred stock of Federal, and could reasonably have anticipated the possibility of challenge to their purchase program (R. 164). As the record showed, criticism had actually been voiced at the early hearings with respect to the management's pre-registration purchases of preferred stock and the management had given partial acknowledgment of the validity of the criticism by mutually agreeing not to purchase before plans were publicly announced.²⁴ In addition, the provisions of Section 77B, as augmented in 1938 by Sections 212 and 249 of Chapter X, indicated that there was at the time of the management's purchases a "climate of opinion" condemning and penalizing similar practices in a related field.

In sum, the Commission's approach to the problem was that of carefully, judiciously weighing the mischiefs of a contrary course of action. See *Addison v. Holly Hill Fruit Products, Inc.*,

plans are prepared" would be impeded and the Commission would be unable to prevent "a group of favored insiders [from continuing] their domination over inarticulate and helpless minorities, or even, as is often the case, majorities * * *." (S. Rep. No. 621, 74th Cong., 1st Sess., p. 33.)

²⁴The record shows there was some deviation from this policy, perhaps unintentional, and that some members of the management had differing ideas of what was a proper time to purchase shares (R. 46, 49, 51-53, 54-57, 60-62, 64-67, 70-71, 75-76, 144).

322 U. S. 607, 622.²⁵ Since the Commission and not the court below had the responsibility of deciding whether to restrict itself to laying down standards applicable to future cases or whether it should apply the fair and equitable standard to limit the management's purchases to cost in this case, we submit that the reversal of the Commission's order by the court below was an im-

²⁵ Viewing the problem as one of administrative discretion, we freely concede that under some circumstances it may be appropriate for the administrative agency to limit itself to announcement of future policy or the prescription of a rule applicable to future cases. Respondents in the court below urged that "the Commission now is well aware that prohibitions involving the promulgation of new policies should be prospective in their operation," citing in this connection the Commission's decision in *Western Light and Telephone Company, Holding Company Act Release No. 5902* (July 2, 1945), where a policy to preclude participation in competitive bidding on the part of a person employed as financial adviser by the issuer was announced for the future, although not applied to the particular case. An earlier instance might have been cited. See *El Paso Electric Co.*, 8 S. E. C. 366, 377-78 (1940), where reliance upon the existence of prior Commission decisions which might have been considered to have reached a contrary result was held to justify non-application of the newly announced standards in the pending case. To the same effect, see *Mississippi River Power Company, Holding Company Act Release No. 5776*, pp. 27-28 (May 4, 1945). Of course, the Commission recognizes that under some circumstances it is appropriate to follow such a course. But, for the reasons indicated in the text, the Commission's determination in the present instance to decide the case before it reflects a rational administrative judgment which should not be overturned upon review.

proper substitution of that court's judgment for the judgment of the Commission.

CONCLUSION

For the foregoing reasons, the judgment of the court below should be reversed and the order of the Commission should be affirmed.

Respectfully submitted.

✓ J. HOWARD McGRATH,
Solicitor General.

✓ ROGER S. FOSTER,
Solicitor.

✓ THEODORE L. THAU,
Special Assistant.

HARRY G. SLATER,
*Counsel-Public Utilities Div.
Securities and Exchange Commission.*

SEPTEMBER 1946.

APPENDIX

Section 7 (d) (6) of the Public Utility Act of 1935 (49 Stat. 803, 15 U. S. C. § 79, *et seq.*), in pertinent part, provides:

If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

* * * * *

the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

Section 7 (e) provides:

If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

Section 11 (e) provides:

In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors

or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

FILE COPY

81-82

NOS. 1088-1089

RECEIVED
APR 29 1946
CHARLES ELMORE GARDNER

Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

CHENERY CORPORATION, *et al.*

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

FEDERAL WATER AND GAS CORPORATION

ON PETITION FOR WRITS OF HABEAS CORPUS TO THE UNITED STATES
COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE CHENERY CORPORATION, ET AL.,
IN OPPOSITION

SPENCER GORDON,
CHARLES A. HORSKY,
Counsel for Respondents.

WINGTON, BURLING, RUBLEE,
ACHESON & SHORR,
Of Counsel.

April, 1946.

INDEX.

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statutes Involved	2
Statement	2
Argument	10

CITATIONS.

<i>Chenery Corporation v. Securities and Exchange Commission</i> , 128 F. (2d) 303, <i>affirmed</i> , 318 U. S. 80.	2, 10, 11
<i>Havender v. Federal United Corporation</i> , 11 A. (2d) 331	4
Public Utility Holding Company Act of 1935 (49 Stat. 838 U. S. C., Title 15, Secs. 79 <i>et seq.</i>)	<i>passim</i>
S. E. C. Holding Company Act Release No. 5584.	1

Supreme Court of the United States

OCTOBER TERM, 1945

No. 1088

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

CHENERY CORPORATION, *et al.*

No. 1089

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

FEDERAL WATER AND GAS CORPORATION

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

**BRIEF FOR THE CHENERY CORPORATION, ET AL.,
IN OPPOSITION**

OPINIONS BELOW

The opinion of the Court below (R. 172-179) is not yet officially reported. The findings and opinion of the Commission (R. 128-169) are S.E.C. Holding Company Act Release No. 5584. The prior opinions in this matter on the previous petition for review are contained in 8 S.E.C. 893, 10 S.E.C. 200, 128 F. (2d) 303, and 318 U. S. 80.

JURISDICTION

The judgment and decree of the court below was entered on February 4, 1946 (R. 180). Jurisdiction in this Court is invoked under Section 240(a) of the Judicial Code, as amended, and Section 24(a) of the Public Utility Holding Company Act of 1935.

QUESTION PRESENTED

Has the decision and judgment of the Court of Appeals properly construed the opinion of this Court on the previous petition for review, 318 U. S. 80?

STATUTES INVOLVED

Pertinent sections of the Public Utility Holding Company Act of 1935 (49 Stat. 838, U. S. C., Title 15, Secs. 79 *et seq.*) are set forth in the Petition, pp. 22-23.

STATEMENT

On September 24, 1941, the Securities and Exchange Commission approved a plan of reorganization of Federal Water Service Corporation (hereafter referred to as Federal) and its merger with two other corporations. The plan provided that certain preferred stock of Federal, which had been purchased by respondents while successive plans were before the Commission, could not be exchanged for common stock of the surviving corporation as was permitted to all other preferred stock, but instead could only be surrendered to the surviving corporation for cost, plus four per cent interest. On petition for review by respondents, this order was set aside by the Court below so far as it related to respondents' preferred stock so purchased. *Chenery Corporation v. Securities and Exchange Commission*, 128 F. (2d) 303. On *certiorari*, this decision was affirmed, 318 U. S. 80. On April 5, 1943, pursuant to the mandate, the cause was remanded to the Commission for further proceedings not inconsistent with the opinion of this Court (R. 117-118).

The Commission thereupon heard further arguments, but took no additional evidence. On February 7, 1945, it entered the order from which the present petition for review is taken (R. 169-170), which reaffirms, without change, its order of September 24, 1941. The facts, consequently, are identical with those in the prior proceedings. They may be stated, in summary fashion, as follows:

Federal was a holding company owning securities of subsidiaries which operated water, gas, electric and other properties. In November, 1937, it registered with the Securities and Exchange Commission under the Public Utilities Holding Company Act of 1935, and filed an application under Section 7 of that Act for a report on a plan of reorganization and declarations regarding the alteration of rights of holders of outstanding securities and the solicitation of consents (R. 40, 41).

At the time the application and declarations were filed, Federal had six classes of outstanding stock—four series of preferred stock, Class A stock and Class B stock. Dividends in arrears had accumulated on all the preferred series and on the Class A stock. Federal had valuable assets and had substantial net income, but by reason of earlier losses and depreciation in the value of investments, the corporation had a capital deficit which under Delaware law prevented the payment of dividends. The plan contemplated the simplification of the corporate structure and the elimination of the capital deficit by a reduction of capital, so that the corporation might resume dividend payments (R. 131-133).

The Commission objected to the plan first proposed, and, as a result of continuing discussion with its representatives, new plans and amendments were filed which would at the same time comply with the law of Delaware as to the rights of holders of preferred stock to arrears of dividends, command the necessary consent of the stockholders of Federal, and which the Commission would permit to become effective under the Public Utility Holding Company

Act of 1935. Not until January, 1940, did the Delaware courts establish that one of the essential prerequisites to a solution could be met by way of merger. *Havender v. Federal United Corporation*, 11 A. (2d) 331. Thereupon, in March, 1940, Federal filed amendments setting forth a new plan of reorganization by way of merger with two other Delaware corporations, Utility Operators Company and Federal Water and Gas Corporation. The latter was wholly owned by Federal. The former, the stock of which was largely owned by officers and employees of Federal and its subsidiaries, owned all of the Class B stock of Federal (R. 131-137).

From November 8, 1937, to June 30, 1940, respondents purchased preferred stock in Federal as follows (R. 79-84):

Name	Shares		
	\$6.00 Preferred	\$6.50 Preferred	\$7.00 Preferred
Chenery Corporation	3860	3547	1211
H. M. Erskine	25	50	....
R. H. Neilson	10	....	....
W. A. Culin	50	110	....
F. T. Tansill	....	65	....
H. D. McHenry	....	75	15
T. H. Wiggins	50	30	....
C. M. Chenery	150	170	....
J. N. Greene	45	....	....
H. G. Calder	....	40	....
C. P. Rather	110	310	....
Wm. E. Matthews, III	....	65	....
C. van den Berg, Jr.	25	1535	140
W. R. Edwards	100	....	....
Watson Dark	5	160	60
E. C. Deal	85	....	....
F. R. Harris	130	173	40
E. C. Elliott	27	....	....
Total purchased by respondents	4672	6330	1466

A comparison of these purchases with the total stock transferred during the period and the total stock outstanding in each class is:

	\$6.00 Preferred	\$6.50 Preferred	\$7.00 Preferred
Total outstanding	71,706	69,888	15,296
Transfers during period from January 1, 1938, to June 30, 1940 ¹	69,578	61,595	12,919
Purchased by respondents during period from Novem- ber 8, 1937, to June 30, 1940	4,672	6,633	1,466

The only sales of this stock by respondents during the period were: C. M. Chenery sold 125 shares of the \$6.00 preferred stock and 20 shares of the \$6.50 preferred stock, and C. van den Berg, Jr., sold 25 shares of the \$6.00 preferred stock and 700 shares of the \$6.50 preferred stock (R. 79-84).

During the time these purchases were made, respondents, other than Chenery Corporation, were officers or directors of Federal or Utility Operators Company. Chenery Corporation was a family holding company with nine stockholders, of whom two, with about 47 per cent of its stock, were officers or directors of Federal or Utility Operators Company. All these purchases and sales were currently reported to the Commission as required by Section 17 of the Act (R. 35, 138).

On June 29, 1940, the Commission issued tentative findings on the merger plan. For the first time, the question was raised whether this preferred stock so purchased should be treated on a different basis than other preferred stock. Hearings were had on this question, and C. T. Chenery, President of Federal, testified that he had advised the purchase of preferred stock of Federal by Chenery Corporation, and by the individual officers and directors, because

¹ This does not include transfers from November 8, 1937, to December 31, 1937, inclusive, since the evidence only gave that year as a whole. Respondents purchased something less than 9 per cent of the stock sold.

he believed that the preferred stock was a very good investment, and because by its purchase the management could maintain a voting interest if the B stock should be eliminated.² In its present decision, the Commission quotes Mr. Chenery's testimony as to the reason for their purchases as follows (R. 141-144):

"Chenery Corporation purchased it on my advice. I have felt, have testified, and have told everyone who has asked me over the past years that I thought that preferred stock of Federal Water Service Corporation, over a long period of time, was sufficiently sound so that it would again pay dividends and that this would be true whether any plan of reclassification was consummated or not, that there were inherent values in the Corporation which would be reflected in the stock and that if no plan of reclassification were put through, that the accumulation of the earnings over a period of time would be sufficient to cure the deficit and dividends would again be resumed.

"Also, the officers and employees of this Corporation bought the B stock in 1932 at my suggestion and on my advice and paid approximately \$600,000 for it, contracted to pay more.³ The situation of the Corporation since that time has improved substantially. This B stock was bought by all classes of employees. I think more than 99 per cent of officers and employees bought it and paid for it by deductions from their salaries over a three or four-year period.

²The court below summarized it as follows (R. 174): "Accordingly, we had then [on the prior petition for review], as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' [respondents'] declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives."

³Mr. Chenery refers to the purchase of B stock by Utility Operators Company, the stock of which was taken in large part by officers and employees of the system.

"The original plans for reclassification contemplated that the B stockholders would be given an opportunity to buy their way back in the Corporation, first by giving them a special stock which was convertible into new common stock upon the payment of cash and which maintained their voting power over a period of years; second, by giving them options so that it was all the time contemplated that these people who held this Corporation together by contributions from their salaries and wages should not be thrown out. I have always regarded the ownership of this stock by the employees of the Corporation as one of the great assets of the Corporation.

"Then the view shifted and apparently the feeling was that little consideration should be given to the B stock and finally that none should be given to it. The voting control of the B stock was thrown into the open market for anybody to pick up who desired it. I had knowledge first that the preferred stock was freely traded on the market, that there were any number of investment bankers buying and selling it constantly and secondly, that strong financial interests were accumulating substantial blocks of this stock.

"As long as we thought that a plan would be worked out which would give the B stock an opportunity to come back in the future, my suggestion was to those stockholders, and I think I testified to this effect at the first hearing here in 1937, that they should save so that at the expiration or at the end of the period, they would be in a position to exercise the option and acquire that stock. Then when it became apparent that this was not to be, a meeting was held of the B stockholders and it was their decision that they would contest any plan which worked them out completely and the suggestion was made that it would be wise to purchase such preferred stock as they reasonably could so that in the event that there was litigation and the plan was not worked out and that finally it should be held that the B stock was not entitled to anything, that these men who had held this Corporation together and who were its loyal servants would still have some position in the Corporation, some voice.

.

" . . . I wanted the employees if they lost the B stock to have some secondary line of defense, which I thought would be in the ownership of the preferred stock, and I said it was my view that it was sound policy for every person in the employ of the company who could spare the money to buy such preferred stock as they could carry, and that I would buy all that I could, through the Chenery Corporation.

"Many of them did buy such preferred stock. In some cases groups got together and borrowed money from the bank to be paid over a period of time with which to buy this preferred stock."

"In the case of Chenery Corporation, we liquidated dividend-paying securities at a loss in order to buy this stock.

"The pendency of the plan, the time of the plan, had nothing to do with it. When we could sell this stock and buy up Federal preferred on pre-determined ratios, the orders to the brokers were to sell the other stock and buy Federal preferred."

"Now I take full responsibility for the purchase of stock by officers and employees. I not only thought it was a sound thing for them to do, I thought it was highly desirable, not only from their viewpoint but from the viewpoint of the corporation, and I so expressed that opinion. I also said that I thought that the stock was inherently sound, that over a period of time, whether we had a plan or did not have a plan, that they wouldn't have any loss in the stock."

His testimony also showed that both the stockholders and the public had had full information in regard to the corporation, including the various plans and the financial reports as filed with the Commission (R. 47, 49, 50, 54-55).

Stock of Federal was sold in the over-the-counter market, and its quotations appeared daily in the newspapers. All of the purchases in question were upon the open market, except one instance in which Chenery Corporation acquired 2700 shares of 6½ per cent preferred from the investment house of Ingalls & Snyder in exchange for \$100,000 principal amount of Federal debentures. Mr. Ingalls testified

that his firm had full knowledge of the facts, and that he was delighted with the trade (R. 58-59).⁴

In March, 1941, the Commission filed formal findings and an opinion. The plan then under consideration had contemplated the conversion of the four classes of preferred into new common stock. The Commission stated that the plan could not be approved insofar as it provided for participation of the preferred shares thus purchased by respondents on a parity with other shares of preferred (8 S.E.C. 893). The Commission held that officers and directors were "trustees" who had purchased trust property, that they must account for any profit on such purchases, and that

* * * honesty, full disclosure and purchase at a fair price do not take the case out of the rule.

Thereafter amendments were filed in order to comply with the opinion of the Commission. The amendments contemplated that no common stock should be issued for the preferred stock bought by respondents since November 8, 1937, and that instead each respondent should receive upon surrender of such stock to the surviving corporation the cost of such stock with interest at 4 per cent per annum from the date of its purchase to the effective date of the merger, and that in effect respondents should account to the surviving corporation for any profit realized on any such stock as had been sold by them (R. 145). Respondents thereupon sought and were allowed to intervene and object to the amended plan in these respects; but on September 24, 1941, the Commission, by supplemental findings and opinion, entered an order approving the amended plan and permitting

⁴ In the present proceeding the Commission found that respondents paid \$328,347 for all of the preferred stock in question, and that they now stood to receive new common stock having a par value and probable market value of approximately \$395,385 (R. 139). To the extent that this last admittedly approximate figure may be considered indicative, it obviously represents no more than ordinary market fluctuations during a period of several years.

the amended declarations to become effective, thus in effect denying the intervening petitions (10 S.E.C. 200). It was this order which was reviewed, and denied effect, in the prior proceedings already referred to.

ARGUMENT

1. The Petition sets forth a variety of alleged reasons why the court below failed properly to interpret the opinion of this Court in the prior proceeding. Actually, the arguments amount to no more than a petition for rehearing, for it is plain that despite the few phrases culled from context upon which the Petition relies, the court below committed no error.

In its prior opinion the Court stated (318 U. S. at pp. 92-93; R. 109):

* * * But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority.

Then the Court continued:

* * * Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11(e), promulgated new general standards of conduct.⁵

⁵ The Petition (p. 15) relies upon the sentence in the opinion to the effect that "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." That sentence, however, immediately precedes the statement quoted above, and was obviously designed to explain how such subtle problems could properly be met.

That situation has not changed. Neither the courts, nor Congress, nor the Commission has issued new general standards. Indeed, in its present decision the Commission specifically refuses to do so (R. 166-168) because without "flexibility" a general standard of conduct might "operate unfairly." The Commission, in other words, is unwilling to exercise its power to formulate "standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the . . . Act of 1935 became law" (318 U. S. at p. 89; R. 106). Concededly, therefore, these transactions fall under no general prohibition.

Nor, in view of the opinion, can it be urged that the transactions represent, in and of themselves, any breach of fair and open dealing. This Court stated (318 U. S. at p. 93; R. 109):

The Commission's determination can stand, therefore, only if it proved that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission.⁶

There is nothing in that statement which warrants the inference in the Petition that the Commission may now—its prior perception of the good faith of respondents dulled

⁶ The Court of Appeals stated in its prior opinion (128 F. (2d) at p. 306): "The Commission's brief and argument in this court explicitly declare that the conclusion to outlaw this stock is not 'predicated on any finding that petitioners [respondents] defrauded or failed to make the fullest disclosure to the stockholders from whom they purchased the shares in question.' On the contrary, the Commission, very properly, admits that the transactions complained of were consummated without 'any ulterior purpose' and equally without any intention to profit personally 'in the consummation of the plan through having traded while the proceedings were pending'."

by the passage of years and the refusal to enforce its prior determination—justify its *ad hoc* proscription in this case by its suggestion that “doubts * * * remain unresolved” (R. 149). The record is still exactly the same record as it was before. The Court below has simply held, as this Court had already held, that if there is nothing in the transactions *generally* prohibited, and that if there is nothing in the transactions to which *specific* objection can be made; then the transactions should not be denied their normal effect. The Court did not, as the Petition suggests (*e.g.*, pp. 12, 14), require a finding of “conscious wrongdoing”. The Court did hold that the mere expression of a “doubt” as to transactions which the Commission has often conceded to be free from taint was not enough to warrant their outlawry.

2. The Petition also contends that the court below ignored that part of the prior opinion of this Court which referred to other findings which might have been made and which might have supported an outlawry (318 U. S. at p. 94, R. 110). Patently, that language could not have been intended to overrule the statements in the opinion quoted above. The Court was not instructing the Commission simply to rewrite its opinion and reaffirm its prior conclusion. The Commission might have brought new facts to the attention of the Court; it chose not to reopen the hearings. It still insists that it need not find, on evidence, that the transactions were either generally or intrinsically bad. The Petition simply overlooks the fact that the opinion emphasized that the Court was not “enforcing formal requirements”, nor “sticking in the bark of words” (318 U. S. at p. 95; R. 111). That, however, is precisely what the Commission itself has done. It adduces, now, only a “doubt”. To conclude that the prior opinion of the Court is satisfied by that is to conclude that it meant nothing at all.

3. This controversy has already been once disposed of by this Court. It has now been disposed of again by unanimous opinion in the court below. The important issues in the administration of the Act which warranted the prior

writ of *certiorari* are disposed of by the prior opinion. The controversy now relates only to the result in this particular case; as stated above, the Petition is in effect a motion for reargument. Any possible question as to the scope of the opinion of this Court can far better be resolved by proceedings in some future case where different facts may afford a proper occasion for further elaboration:

SPENCER GORDON,
CHARLES A. HORSKY,
Counsel for Respondents.

COVINGTON, BURLING, RUBLEE,
ACHESON & SHORB,
Of Counsel.

April, 1946.

FILE COPY

81-82

Office - Supreme Court, U. S.

FILED

MAY 1 1946

CHARLES ELMORE GROFFLY
CLERK

No. ~~1088-1089~~

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION,

Petitioner

v.

CHENERY CORPORATION, *et al*

SECURITIES AND EXCHANGE COMMISSION,

Petitioner

v.

FEDERAL WATER AND GAS CORPORATION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE DISTRICT OF
COLUMBIA

**BRIEF FOR FEDERAL WATER AND GAS
CORPORATION IN OPPOSITION**

ALLEN S. HUBBARD

*Counsel for Federal Water
and Gas Corporation*

HUGHES, HUBBARD & EWING

Of Counsel

April, 1946.

INDEX

	PAGE
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	2
Argument	5

CITATIONS

Cases:

Securities and Exchange Commission v. Chenery Corporation, 318 U. S. 80..... 4, 9

Statutes:

Sec. 7, Public Utility Holding Company Act..... 2, 3

Sec. 11, Public Utility Holding Company Act..... 2, 3

Nos. 1088-1089.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

v.

CHENERY CORPORATION, *et al*

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

v.

FEDERAL WATER AND GAS CORPORATION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE DISTRICT OF
COLUMBIA

**BRIEF FOR FEDERAL WATER AND GAS
CORPORATION IN OPPOSITION**

Opinions Below

The opinion of the Court of Appeals (R. 172-179) has not yet been officially reported. The findings and opinion of the Commission, which accompanied its order of February 7, 1945 (R. 128) are reported in S. E. C. Holding Company Act Release No. 5584.

Jurisdiction

The judgment of the Court of Appeals was entered February 4, 1946 (R: 180). The petition for writs of certiorari was filed on April 8, 1946 and served on April 10, 1946. The jurisdiction of this Court is invoked under Section 240a of the Judicial Code as amended, which is made applicable by Section 24(a) of the Public Utility Holding Company Act of 1935.

Question Presented

Did the Court below err in setting aside the order of the Securities and Exchange Commission entered on February 7, 1945 and remanding the causes to the Commission for further proceedings not inconsistent with the opinion of that Court?

Statute Involved

Relevant provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 838, 15 U. S. C., Secs. 79 et seq. are set forth in the Appendix to the Petition.

Statement

Section 7(d)(6) of the Public Utility Holding Company Act of 1935 authorizes the Commission to refuse to permit a declaration regarding the issue or sale of a security by a registered holding company to become effective if the Commission finds that "the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers."

Section 11(e) authorizes a registered holding company to submit to the Commission a plan for the purpose of enabling the company to comply with the provisions of sub-

section (b) and authorizes the Commission to make an order approving the plan if the Commission finds that the plan is "necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by the plan." Section 11(c) further authorizes the Commission at the request of the company to apply to a United States District Court to enforce and carry out the terms of the plan and authorizes the Court to enforce the plan, if after hearing the Court approves the plan "as fair and equitable, and as appropriate to effectuate the provisions of Section 11".

Purporting to act under the authority granted to it by Sections 7 and 11 of the Public Utility Holding Company Act, the Commission on March 24, 1941 entered an order denying effectiveness to declarations which proposed to the Commission a merger under Section 59 of the Delaware Corporation Law between Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation unless the proposed merger agreement was amended so as to discriminate against stock owned by officers or directors of Federal Water Service Corporation or Utility Operators Company and purchased by them after November 8, 1937 (8 S. E. C. 893).

The merger agreement was amended so as to meet the views of the Commission and, as amended, was approved by order entered September 24, 1941 (10 S. E. C. 200). It was consummated on October 31, 1941 pursuant to the votes of stockholders in accordance with Delaware Corporation Law, leaving the officers and directors affected by the discriminatory paragraph in the merger agreement with the right to review the order of the Commission (R. 121).

On review by the Court of Appeals for the District of Columbia, the order of the Commission of September 24,

1941 approving the discriminatory paragraph of the merger agreement was reversed and the cause remanded for further proceedings in conformity with the Court's opinion (*Chenery Corporation v. Securities and Exchange Commission*, 128 F. (2d) 303). On certiorari, this Court directed that the cause be remanded to the Commission for further action not inconsistent with its opinion (*Securities and Exchange Commission v. Chenery Corporation*, 318 U. S. 80).

Following the entry of the order of the Court of Appeals on the mandate of this Court (R. 117-118) Federal Water and Gas Corporation, the surviving corporation, filed with the Commission an application and declaration requesting that an appropriate order be entered permitting it to submit to its stockholders at a special meeting to be called for that purpose a proposed amendment to the merger agreement, the effect of which, if adopted by the stockholders, would be to eliminate the discriminatory paragraph in the merger agreement and permit the stockholders discriminated against to exchange their outstanding certificates of preferred stock of Federal Water Service Corporation for certificates of common stock of the surviving corporation and receive the dividends which they would have received if they had been accorded parity of treatment by the merger agreement. At the same time they moved the Commission that such proceedings be had as might be necessary to treat them on the same basis as other holders of preferred stock of Federal Water Service Corporation of the same class (R. 127). No additional testimony was taken on these applications. On February 7, 1945, the Commission denied the application of Federal Water and Gas Corporation for leave to amend the merger agreement on the ground that its order of September 24, 1941 should be reaffirmed.

Argument

In its opinion of March 24, 1941, the Commission said (8 S. E. C. 916-920):

"* * * Corporate directors are fiduciaries—their powers are powers in trust (*Pepper v. Litton*, 308 U. S. 295). We hold further that in the process of formulation of a 'voluntary' reorganization plan, the management of a corporation occupies a fiduciary position toward all of the security holders to be affected, and that it is subjected to the same standards as other fiduciaries with respect to dealing with the property which is the subject matter of the trust. Of course, the management does not hold title to the securities, but its duty of fair dealing with the persons for whom it acts is as great as is that of a trustee who holds title to a res for the benefit of his beneficiaries. A trustee may not 'become the purchaser of the property which he represents or any portion of it though he has done so for a fair price without fraud at a public sale.' *Michoud v. Girod*, 4 How. 502, 557 (1846). Accordingly, honesty, full disclosure and purchase at a fair price do not take the case outside the rule. The need for an inflexible rule was recognized in *Michoud v. Girod*, *supra*:

'Is it not better that the cause of the evil shall be prohibited, than that courts of equity shall be relied upon to apply the remedy in particular cases, by inquiring into all the circumstances of a case, whether there has or has not been fraud in fact?'

* * *

The result of these cases does not depend on dishonesty or unfair dealing, for it was conceded in the *Otis* case, *supra*, that the brokerage house which acted as committee had lost money in the transac-

tions, that it had acted in good faith, that the sellers of the bonds knew that the house was representing the bondholders, and that it had entered into the transactions 'for the accommodation' of its customers. Similar facts appeared in the *Mountain States* case. * * *

We think that the authorities heretofore cited are fully applicable to the position of the management of a corporation trading in the securities which will be affected by a voluntary plan of reorganization upon which the management is working. We, no more than a court of equity, should undertake to decide case by case whether the management's trading has in fact operated to the detriment of the persons whom it represents. * * *

Similarly, deciding whether the terms of issuance of the new common stock are fair and equitable or are detrimental to the interests of investors, we must find that they are unfair, inequitable, and detrimental, so long as the preferred stock purchased by the management at low prices is to be permitted to share on a parity with other preferred stock. * * *

In its opinion of February 7, 1945, the Commission said (R. 163-165):

"As we have already indicated, the personal integrity of these particular interveners is not a question at issue in this case. For obvious reasons we do not conceive it our function to try to guess whether a reorganization manager, faced with a choice of conducting the reorganization for the accomplishment of his own objectives or for the benefit of security holders generally, is the kind of man who would be likely to take one course and not the other. What we say is that when reorganization

managers have undertaken a program of acquiring their company's securities for their own account, in contemplation of or during the reorganization proceedings under their charge, they have placed themselves in a position where they are peculiarly susceptible to temptation to conduct the reorganization for personal gain rather than the public good; the program of making advantageous purchases of stock could have had an important influence—even though subconsciously—upon great numbers of business decisions all along the way. * * * What we mean, therefore—and we cannot emphasize this too strongly—is that concepts of 'honesty, full disclosure and purchase at a fair price,' traditionally applied to dealings in normal course between corporate managers and stockholders, cannot be the controlling tests in the decision of this case. * * * Since the more subtle, though powerful, forms of such conduct defies specific proof and since the application of a subjective standard of good faith would in any event be inappropriate here, we must foreclose an inquiry into the motives and intentions of reorganization managers who have engaged in so potentially harmful a practice as seeking to profit by a program of security purchases during the course of a reorganization in which they take so important a role. * * * The problem before us is, therefore, one of temptations combined with powers of accomplishment. Since the achieving of personal gain through the use of fiduciary power is unfair, we believe the incentive to misuse such power must be removed so that the potentialities of harm to investors and the public will to that extent be eliminated."

It is apparent that there is no substantial difference between these two decisions. In both of them the Commission sought to decide the case before it by giving retroactive

effect to a new policy as to purchases of stock by officers and directors.

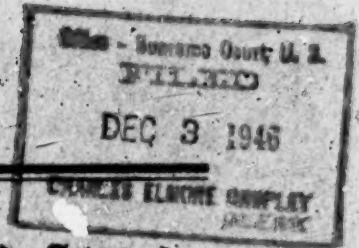
This Court's former opinion was rendered on February 1, 1943. Federal Water and Gas Corporation's application for leave to amend the merger agreement was filed on April 7, 1943. The Commission's decision was rendered February 7, 1945, approximately two years after this Court's decision. The granting of certiorari could only result in further delay.

ALLEN S. HUBBARD
*Counsel for Federal Water
and Gas Corporation*

HUGHES, HUBBARD & EWING
Of Counsel

April, 1946.

FILE COPY



Supreme Court of the United States

OCTOBER TERM, 1946.

No. 81.

SECURITIES AND EXCHANGE COMMISSION, *Petitioner,*

v.

CHENERY CORPORATION, ET AL.

**On Writ of Certiorari to the United States Court of Appeals
for the District of Columbia.**

**BRIEF FOR THE RESPONDENTS CHENERY
CORPORATION, ET AL.**

**SPENCER GORDON,
*Attorney for Respondents.***

**COVINGTON, BURLING, RUBLES,
ACHESON & SHORR,
Washington, D. C.**

TABLE OF CONTENTS.

	Page
Opinions below	1
Jurisdiction	2
Statement of case	2
Original proceedings before the Commission	2
First judicial review	11
Subsequent proceedings before the Commission	14
Second judicial review	16
Summary of argument	18
Argument	19
1. The record, findings, decision and order are essentially the same as on the prior review	19
2. The Commission has misinterpreted the decision of this Court	22
3. The Commission's order is not supported by the findings of fact or by the evidence. It is wholly arbitrary.	25
4. The Commission's order amounts to retroactive legislation depriving the respondents of property without due process of law	29
Conclusion	35
Appendix of statutes	36

INDEX OF AUTHORITIES.

CASES

Addison v. Holly Hill Fruit Products, Inc., 322 U. S. 607	30
Blodgett v. Holden, 275 U. S. 142, mod. 276 U. S. 594	33
Chenery Corporation v. Securities and Exchange Commission, 75 U. S. App. D. C. 374, 128 F. (2d) 303	12, 20

	Page
Chenery Corporation v. Securities and Exchange Commission, 80 U. S. App. D. C. 365, 134 F. (2d) 6	17, 18, 26, 28, 29
Coolidge v. Long, 282 U. S. 582	33
County of Ralls v. Douglass, 105 U. S. 728	34
Douglass v. County of Pike, 101 U. S. 677	34
Eagleson v. Pacific Timber Company, 270 Fed. 1008	32
Ettor v. Tacoma, 228 U. S. 148	33
Federal Water Service Corp., et al., 8 S. E. C. 893, 10 S. E. C. 200	10, 11, 20
Gelpcke v. Dubuque, 1 Wall. (68 U. S.) 175	34
Green Co. v. Conness, 109 U. S. 104	34
Havemeyer v. Iowa Co., 3 Wall. (70 U. S.) 294	34
Havender v. Federal United Corporation, 11 A. (2d) 331	3
Ex Parte Lacey, 6 Vesey 625. (1802)	28
Muhlker v. N. Y. & Harlem Railroad Company, 197 U. S. 544	34
Nichols v. Coolidge, 274 U. S. 531	33
Ochoa v. Hernandez y Morales, 230 U. S. 139	32, 33
Olcott v. Supervisors, 16 Wall. (83 U. S.) 678	34
Securities and Exchange Commission v. Chenery Corporation, 318 U. S. 80, 87 L. Ed. 626	13, 14, 18, 20, 21, 22, 23, 24, 26, 27, 31
Treigle v. Acme Homestead Assn., 297 U. S. 189	33
Untermeyer v. Anderson, 276 U. S. 440	33
Western Light and Telephone Company, Holding Company Act Release No. 5902	29
Wood v. Lovett, 313 U. S. 362	33

CONSTITUTION AND STATUTES

United States Constitution, Amendment 5	31, 32
Administrative Procedure Act, Pub. L. No. 404, 79th Cong., 2nd Sess. (June 11, 1946)	31
Delaware Corporation Law, Secs. 26 and 28	2
Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. Sec. 79 <i>et seq.</i>	
Sec. 6 (a)	36
Sec. 7(a)	25, 36
Sec. 7(d)	25, 36
Sec. 7(e)	25, 36

Index Continued.

iii

Page

Sec. 11(b)	37
Sec. 11(e)	24, 25, 37
Sec. 20(d)	31, 38

ARTICLES, TEXTS AND OTHER AUTHORITIES

Accrued Dividends on Cumulative Preferred Stocks:

The Legal Doctrine, 55 Harv. L. Rev. 71	3
Fletcher, Cyc. Corp. (Perm. Ed.) Sec. 7206	32
Stimson, Retroactive Application of Law—A Problem in Constitutional Law, 38 Mich. L. Rev. 30...	34

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 81.

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*,

v.

CHENERY CORPORATION, ET AL.

On Writ of Certiorari to the United States Court of Appeals
for the District of Columbia.

**BRIEF FOR THE RESPONDENTS CHENERY
CORPORATION, ET AL.**

OPINIONS BELOW.

The opinion of the Court below (172-179)* is reported in 80 U. S. App. D. C. 365, 134 F. (2d) 6. The findings and opinion of the Commission (128-169) are S. E. C. Holding Company Act Release No. 5584. The prior opinions in this matter on a previous review are contained in 8 S. E. C. 893; 10 S. E. C. 200; 75 U. S. App. D. C. 374, 128 F. (2d) 303; and 318 U. S. 80 (98-117).

* References in parentheses are to pages of the printed record unless otherwise indicated.

JURISDICTION.

The judgment of the Court of Appeals was entered February 4, 1946 (181). The petition for writ of certiorari was filed April 8, 1946, and was granted May 13, 1946 (184-185). This Court appears to have jurisdiction under Section 240(a) of the Judicial Code, as amended, which is made applicable by Section 24(a) of the Public Utility Holding Company Act of 1935.

STATEMENT OF CASE.

Original Proceedings Before the Commission.

Federal Water Service Corporation, a Delaware Corporation (hereinafter called Federal), was a holding company owning securities of subsidiaries which operated water, gas, electric and other properties. November 8, 1937, Federal registered with the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935, and filed with the Commission, under Section 7 of said Act and the rules of the Commission, an application for a report on a plan of reorganization, and declarations regarding the alteration of rights of holders of outstanding securities and the solicitation of consents. The application and declarations set forth a plan for the voluntary reorganization of Federal, to be accomplished by amendment to its certificate of incorporation pursuant to Section 26 of the Delaware Corporation Law, and by a reduction in its capital pursuant to Section 28 of the Delaware Corporation Law. At the time of the filing of the application and declarations, Federal had outstanding six classes or series of stock: \$7, \$6.50, \$6, \$4 series preferred stock, Class A stock and Class B stock. Dividends in arrears had accumulated on all series of preferred stock and upon the Class A stock. Federal had valuable assets and had substantial annual net income, but, by reason of earlier losses and depreciation in the value

of investments, the corporation had a capital deficit which under Delaware law prevented the payment of dividends. The plan contemplated the simplification of the corporate structure and the elimination of the capital deficit by a reduction of capital, so that the corporation might resume the payment of dividends. (40, 41, 131-135)

The Commission objected to the plan first proposed, new plans were filed, and continued discussions were had with representatives of the Commission toward the development of a plan which the Commission would permit to become effective under the Public Utility Holding Company Act of 1935, which would comply with the law of Delaware as to the rights of holders of preferred stock to arrears of dividends, and which would also command the necessary consent of the stockholders of Federal as required by Delaware law. After the decision on January 16, 1940, in *Havender v. Federal United Corporation*, 11 A. (2d) 331,* which established that under Delaware law preferred stock together with dividends in arrears thereon might be converted into new securities through a merger, Federal filed with the Commission on March 30, 1940, amendments to its application and declarations, setting forth a new plan of reorganization by way of merger. The amendments proposed the merger into Federal of two other Delaware corporations, Utility Operators Company and Federal Water and Gas Corporation. Utility Operators Company, the stock of which was largely owned by officers and employees of Federal and its subsidiary companies, owned all of the Class B stock of Federal. Federal owned all of the stock of Federal Water and Gas Corporation. Utility Operators Company and Federal Water and Gas Corporation also filed with the Commission declarations regarding the alteration of the rights of the holders of their securities in

* For a discussion of the Delaware cases as showing the problems faced by the directors of Federal during the period in which the plans were submitted to the Commission, see *Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine*, 55 Harv. L. Rev. 71.

accordance with the proposed merger agreement. (136, 137).

During the period from November 8, 1937, to June 30, 1940, the respondents purchased preferred stock in Federal in amounts as follows:

Name	Shares		
	\$6.00 Preferred	\$6.50 Preferred	\$7.00 Preferred
Chenery Corporation	3860	3547	1211
H. M. Erskine	25	50	—
R. H. Neilson	10	—	—
W. A. Culin	50	110	—
F. T. Tansill	—	65	—
H. D. McHenry	—	75	15
T. H. Wiggin	50	30	—
C. M. Chenery	150	170	—
J. N. Greene	45	—	—
H. G. Calder	—	40	—
C. P. Rather	110	310	—
Wm. E. Matthews, III	—	65	—
C. van den Berg, Jr.	25	1535	140
W. R. Edwards	100	—	—
Watson Dark	5	160	60
E. C. Deal	85	—	—
F. R. Harris	130	173	40
E. C. Elliott	27	—	—
Total purchased by respondents	4672	6330	1466

A comparison of these purchases with the total stock transferred during the period and the total stock outstanding in each class is:

	\$6.00 Preferred	\$6.50 Preferred	\$7.00 Preferred
Total outstanding	71,706	69,888	15,296
Transfers during period from January 1, 1938, to June 30, 1940*	69,578	61,535	12,919
Purchased by respondents during period from November 8, 1937, to June 30, 1940	4,672	6,633	1,466

The only sales of this stock by respondents during the period were: C. M. Chenery sold 125 shares of the \$6.00 preferred stock and 20 shares of the \$6.50 preferred stock, and C. van den Berg, Jr., sold 25 shares of the \$6.00 preferred stock and 700 shares of the \$6.50 preferred stock. (79-83).

When these purchases were made the respondents other than Chenery Corporation were officers or directors of Federal or of Utility Operators Company. Chenery Corporation was a family holding company which had nine stockholders, of whom two, who owned approximately 47 per cent of the stock of Chenery Corporation, were officers or directors of Federal or Utility Operators Company. All of these purchases and sales of stock in Federal were currently reported to the Commission by the purchasers as required by Section 17 of the Public Utility Holding Company Act of 1935. (35, 138).

June 29, 1940, the Commission issued tentative findings in which the question was raised for the first time whether the preferred stock which had been purchased by officers and directors of Federal and Utility Operators Company

* This does not include transfers from November 8, 1937, to December 31, 1937, inclusive, since the evidence only gave that year as a whole. It is an interesting coincidence that during the period in question an amount of stock changed hands which was approximately equal to the total amount outstanding. Respondents purchased something less than 9 per cent of the stock sold.

and by Chenery Corporation while plans of reorganization were pending before the Commission should be treated on any different basis than other preferred stock. Hearings were had on this question, and C. T. Chenery, the President of Federal, testified that he had advised the purchases of preferred stock of Federal by the Chenery Corporation and by the individual officers and directors, because he believed that the preferred stock was a very good investment, and because by its purchase the management could maintain a voting interest if the B stock should be eliminated.* The testimony also showed that full information in regard to the corporation had always been given to the stockholders and to the public. (47, 49, 50):

In its present decision, the Commission quotes Mr. Chenery's testimony as to the reason for these purchases as follows:

"Chenery Corporation purchased it on my advice. I have felt, have testified, and have told everyone who has asked me over the past years that I thought that preferred stock of Federal Water Service Corporation, over a long period of time, was sufficiently sound so that it would again pay dividends and that this would be true whether any plan of reclassification was consummated or not, that there were inherent values in the Corporation which would be reflected in the stock and that if no plan of reclassification were put through, that the accumulation of the earnings over a period of time would be sufficient to cure the deficit and dividends would again be resumed.

"Also, the officers and employees of this Corporation bought the B stock in 1932 at my suggestion and on my advice and paid approximately \$600,000 for it,

* The position of the company had been that it could not put through a voluntary plan of reorganization without the consent of the Class B stock, and that it was not unfair or inequitable to recognize the voting power of the Class B stock in some small way, as that stock was being asked to consent to a modification of its contractual rights. The Commission, however, finally insisted upon the elimination of the B stock, and it was not included in the plan which was ultimately approved.

contracted to pay more.* The situation of the Corporation since that time has improved substantially. This B stock was bought by all classes of employees. I think more than 99 per cent of officers and employees bought it and paid for it by deductions from their salaries over a three or four-year period.

"The original plans for reclassification contemplated that the B stockholders would be given an opportunity to buy their way back in the Corporation, first by giving them a special stock which was convertible into new common stock upon the payment of cash and which maintained their voting power over a period of years; second, by giving them options so that it was all the time contemplated that these people who held this Corporation together by contributions from their salaries and wages should not be thrown out. I have always regarded the ownership of this stock by the employees of the Corporation as one of the great assets of the Corporation.

"Then the view shifted and apparently the feeling was that little consideration should be given to the B stock and finally that none should be given to it. The voting control of the B stock was thrown into the open market for anybody to pick up who desired it. I had knowledge first that the preferred stock was freely traded on the market, that there were any number of investment bankers buying and selling it constantly and secondly, that strong financial interests were accumulating substantial blocks of this stock.

"As long as we thought that a plan would be worked out which would give the B stock an opportunity to come back in the future, my suggestion was to those stockholders, and I think I testified to this effect at the first hearing here in 1937, that they should save so that at the expiration or at the end of the period, they would be in a position to exercise the option and acquire that stock. Then when it became apparent that this was not to be, a meeting was held of the B stockholders and it was their decision that they would contest any plan which worked them out completely and the suggestion was made that it would be wise to purchase such pre-

* Mr. Chenery refers to the purchase of B stock by Utility Operators Company, the stock of which was taken in large part by officers and employees of the system (132).

ferred stock as they reasonably could so that in the event that there was litigation and the plan was not worked out and that finally it should be held that the B-stock was not entitled to anything, that these men who had held this Corporation together and who were its loyal servants would still have some position in the Corporation, some voice.

"* * * I wanted the employees if they lost the B stock to have some secondary line of defense, which I thought would be in the ownership of the preferred stock, and I said it was my view that it was sound policy for every person in the employ of the company who could spare the money to buy such preferred stock as they could carry, and that I would buy all that I could, through the Chenery Corporation.

"Many of them did buy such preferred stock. In some cases groups got together and borrowed money from the bank to be paid over a period of time with which to buy this preferred stock.

"In the case of Chenery Corporation, we liquidated dividend-paying securities at a loss in order to buy this stock.

"The pendency of the plan, the time of the plan, had nothing to do with it. When we could sell this stock and buy up Federal preferred on pre-determined ratios, the orders to the brokers were to sell the other stock and buy Federal preferred.

"Now I take full responsibility for the purchase of stock by officers and employees. I not only thought it was a sound thing for them to do, I thought it was highly desirable, not only from their viewpoint but from the viewpoint of the corporation, and I so expressed that opinion. I also said that I thought that the stock was inherently sound, that over a period of time, whether we had a plan or did not have a plan, that they wouldn't have any loss in the stock." (141-144).

The successive plans for reorganization as filed from time to time with the Commission were available to the public, including all stockholders, as were all financial reports filed with the Commission. Mr. Culin, the treasurer of Federal, testified that the management had always been very free in

giving information to everyone who asked for it. Annual reports of the company gave full information, quarterly earning statements were published in the financial pages of the newspapers, the newspapers carried reports of the plans before the Commission from time to time, and various investment houses also gave information and advice with respect to the stock. (50).

Mr. Chenery testified:

"* * * my feeling has been that if there is one corporation that has ever operated in the full glare of publicity, that this one is it. It was one of the first corporations to start and give full and complete details of every transaction. Standard Statistics has given reports at three-month intervals. There have been a dozen brokerage houses which have circularized preferred stockholders consistently, telling them of every development and plan and advising them what to do. Our own policy has been not to refuse any stockholder any information at any time. There is no record since we have been in control of the company since March 14, 1932, of our having refused any stockholder any information on any subject." (54, 55).

Stock of Federal was sold in the over-the-counter market, and its quotations appeared daily in New York newspapers. All of the purchases in question were made in the open market, except in one instance when Chenery Corporation acquired 2700 shares of 6½ per cent preferred from the investment house of Ingalls & Snyder in exchange for \$100,000 principal amount of Federal debentures. Mr. Ingalls testified that his firm had full knowledge of the facts relating to Federal, and that

"* * * today I am very much delighted we made the trade, * * * it's been a most satisfactory trade." (58).

Mr. Ingalls also testified that he knew that officers and directors of Federal or Utility Operators had been purchasing the preferred stock during the three or four years before he sold his stock. (59).

The present findings of the Commission are that the petitioners paid \$328,347 for all the preferred stock in question and that they stood to receive new common stock "having a par value and probable market value of approximately \$395,385."* (139 f.n.)

March 24, 1941, the Commission filed formal findings and an opinion in the proceeding. The plan then under consideration had contemplated the conversion of the four classes of preferred into new common stock. The Commission stated that the plan could not be approved in so far as it provided for participation of the preferred shares purchased by officers or directors of Federal or Utility Operators Company, or by the Chenery Corporation, after November 8, 1937, on a parity with other shares of preferred stock of the same class. The Commission held that the officers and directors were "trustees" who had purchased trust property, that they must account for any profit on such purchases and that

"... honesty, full disclosure and purchase at a fair price do not take the case out of the rule."

Entry of an order was deferred, and it was stated that further consideration would be given to the matter if Federal filed amendments to its proposed plan designed to cure this and other alleged defects therein. (8 S. E. C. 893).

Thereafter amendments to the declarations and applications were filed by the corporations, in order to present a plan which complied with the findings and opinion of the Commission. The proposed merger agreement was amended to provide among other things that no shares of common stock of the surviving corporation should be issued for the shares of preferred stock of Federal purchased

* To the extent that this approximate figure may be indicative, the increase represents no more than ordinary market fluctuations during a period of several years, or, as the Court of Appeals pointed out, "a difference little more than the amount of interest lost in holding the preferred shares pending completion of the plan" (173).

since November 8, 1937, by Chenery Corporation or by the individual petitioners when they were officers or directors of Federal or of Utility Operators Company, but that each such purchaser should receive upon surrender of such stock to the surviving corporation the cost of such stock with interest at 4 per cent per annum from the dates of its purchase to the effective date of the merger agreement. It was further provided in effect that the respondents should account to the surviving corporation for any profit realized on any such stock as had been sold by them. (145).

August 15, 1941, the respondents filed an application for leave to intervene in the proceedings before the Commission, and objected to the approval of any plan of reorganization containing a provision to the effect that the preferred stock purchased by the respondents should be treated on a less favorable basis than other preferred stock of the same class. August 18, 1941, the respondents were given permission to intervene and were made parties to the proceeding with leave to file a brief. (86, 97, 145).

September 24, 1941, the Commission made a report on the amended plan of reorganization, entered supplemental findings and opinion, and issued an order permitting the declarations, as amended in conformity with the Commission's opinion of March 24, 1941, to become effective, and granting the applications as amended. The effect of this order was to deny the prayers contained in the intervening petition and brief of the respondents. (10 S. E. C. 200).

First Judicial Review.

October 22, 1941, these respondents filed a petition in the United States Court of Appeals for the District of Columbia for review of the order of the Securities and Exchange Commission of September 24, 1941, and prayed that the order be modified or set aside to the extent necessary to treat these petitioners on the same basis as other holders of preferred stock of Federal of the same class.

April 27, 1942, that court entered its opinion in the case. *Chenery Corporation v. Securities and Exchange Commission*, 75 U. S. App. D. C. 374, 128 F. (2d) 303. The court stated in regard to the purchases,

"The Commission's brief and argument in this court explicitly declare that the conclusion to outlaw this stock is not 'predicated on any finding that petitioners defrauded or failed to make the fullest disclosure to the stockholders from whom they purchased the shares in question.' On the contrary, the Commission, very properly, admits that the transactions complained of were consummated without 'any ulterior purpose' and equally without any intention to profit personally 'in the consummation of the plan through having traded while the proceedings were pending'. We have, therefore, a case in which the facts are agreed, the good faith of petitioners admitted, and the decision based squarely on the assumption that the purchase of securities of a corporation by its officers or directors for their own account, pending action on an application for approval of a merger, is 'detrimental to the public interest' as that phrase is used in Section 7(d) (6) of the Act." (p. 377).

The court said further:

"* * * it is admitted that there was a full and free disclosure before any purchases were made, the exercise of the utmost good faith throughout, * * * " (p. 379).

It was held that no statute, regulation, or rule of common law or equity proscribed such purchases of stock, that Congress in enacting the Public Utility Holding Company Act of 1935 had never intended to proscribe an investment made under these circumstances, and that the action of the Commission was equivalent to retrospective legislation. The order of the Commission was therefore reversed.

July 25, 1942, the Securities and Exchange Commission filed a petition for certiorari in this Court, and certiorari was granted October 12, 1942.

February 1, 1943, this Court entered its opinion in the case. *Securities and Exchange Commission v. Chenery Corporation*, 318 U. S. 80, 87 L. Ed. 626. In finding "that the Commission's order cannot be sustained," this Court said: .

"* * * The Commission dealt with this as a specific case, and not as the application of a general rule formulating rules of conduct for reorganization managers. Consequently, it is a vital consideration that the Commission conceded that the respondents did not acquire their stock through any favoring circumstances. In its own words, 'honesty, full disclosure, and purchase at a fair price' characterized the transactions. The Commission did not suggest that, as a result of their purchases of preferred stock, the respondents would be unjustly enriched. On the contrary, the question before the Commission was whether the respondents, simply because they were reorganization managers, should be denied the benefits to be received by the 6,000 other preferred stockholders. Some technical rule of law must have led the Commission to single out the respondents and deny their preferred stock the right to participate equally in the reorganization." (103).

The Court held that the "cases upon which the Commission relied do not establish principles of law and equity which in themselves are sufficient to sustain its order" and said

"* * * Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different. Whether and to what extent directors or officers should be prohibited from buying or selling stock of the corporation during its reorganization, presents problems of policy for the judgment of Congress or of the body to which it has delegated power to deal with the matter. Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions unconcerned with the fairness of a par-

ticular transaction. But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11 (e), promulgated new general standards of conduct. It purported merely to be applying an existing judge-made rule of equity. The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission." (108-109)

The case was remanded to the Court of Appeals with directions to remand it to the Commission for such further proceedings, not inconsistent with the opinion, as might be appropriate. *Securities and Exchange Commission v. Chenery Corporation*, 318 U. S. 80, 87 L. Ed. 626. April 5, 1943, the Court of Appeals issued an order on the mandate of this Court directing that the order of the Securities and Exchange Commission be set aside and remanding the cause to the Commission for such further proceedings, not inconsistent with the opinion of this Court, as might be appropriate.

Subsequent Proceedings Before the Commission

Meanwhile the merger contemplated by the Commission's order of September 24, 1941, had been completed according

to the plan thereby approved, with a provision that no shares of common stock of the surviving corporation should be issued for shares of preferred stock of Federal purchased by the respondents during the reorganization proceedings. In view of the decision by the Supreme Court, Federal Water and Gas Corporation, the surviving corporation, on April 7, 1943, filed an application and declaration asking leave to submit to its stockholders resolutions providing for an amendment and correction of the merger agreement, and for an amendment and correction of the certificate of reduction of capital, so as to permit the issue of stock in the surviving corporation to these respondents on a parity with other preferred stockholders. On the same day these respondents also filed a motion asking that such further proceedings be had as might be necessary to treat them on the same basis as other holders of preferred stock of Federal of the same class, and thereafter filed a brief urging that the application filed by the corporation be approved. The matter was argued orally before the Commission on the existing record. No new evidence was introduced. (118, 127, 129.)

February 7, 1945, the Commission entered an order denying the application of Federal Water and Gas Corporation to amend the plan of reorganization,* and ordering that the plan of reorganization theretofore approved by the Commission's order of September 24, 1941, and the transactions contemplated by said plan be reapproved as of September 24, 1941. The effect of this order of February 7, 1945, was to deny the motion of the respondents that they be treated on the same basis as other holders of preferred stock of Federal of the same class. With its order of February 7, 1945, the Commission filed a statement of facts and conclusions in which the Commission stated as the basis of its decision:

* An order denying the application had theretofore been entered on April 17, 1944, but was withdrawn by the Commission.

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to re-examine the case and to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified." (130).

The decision of the Commission was that its previous determination should be reaffirmed. The Commission held that the plan, if amended, would not be "fair and equitable to the persons affected thereby" within the meaning of Section 11 (e) of the Act, that it would involve the issuance of securities on terms "detrimental to the public interest and the interest of investors" forbidden by Sections 7 (d) (6) and 7 (e) of the Act, and that it would "result in an unfair and inequitable distribution of voting power" within the meaning of the latter section. The Commission stated:

"We are led to this result not by proof that the interveners committed acts of conscious wrongdoing but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration." (149).

"As we have already indicated, the personal integrity of these particular interveners is not a question at issue in this case." (163).

Second Judicial Review.

On March 22, 1945, these respondents again filed a petition in the United States Court of Appeals for the District of Columbia, this time asking for review of the order of the

Commission of February 7, 1945. The respondents again prayed that the order be modified or set aside to the extent necessary to treat them on the same basis as other holders of preferred stock of Federal of the same class (2).

The Court of Appeals again reversed the order of the Commission, this time saying:

"The Commission's position actually amounts to neither more nor less than a definite holding that purchases of stock of a corporation in process of reorganization are unlawful, when made by officers or employees of the corporation—and this without regard to any factor of good or bad faith, or any other factor which might impute special knowledge, secret information, or indeed anything tending to show a lack of bona fides in the transaction. For, as we have seen, the Commission expressly says the integrity of interveners in the respects in which they acted is not at issue. And, as to this latter statement, in passing, we may properly observe that it cannot be, for the Commission has put that issue out of the case by its previous admission of the same facts that 'honesty, full disclosure and purchase at a fair price' characterized the transactions. In practical effect, therefore, the Commission now insists upon doing precisely what the Supreme Court said it could not do; that is to say, in applying to this specific case a standard which has never been promulgated, either by the Commission in its regulations or by legislative act, and which the Commission says can not fairly be generally applied." (176, 177).

"In nothing we have said do we wish to be understood as expressing any opinion as to the right of the Commission under its broad powers to promulgate a rule of general application forbidding officers and directors of a corporation in process of reorganization from buying—and perhaps also from selling—securities of the corporation during the pendency of proceedings before the Commission. That question is not present in this case. What we do say is that, without such a rule, of which notice is given so that all may know of its existence, transactions in themselves fair and

just and honest and in accord with traditional business practices, and which 'Congress itself did not proscribe,' and which 'judicial doctrines do not condemn,' may not properly be 'outlawed or denied' their ordinary effect." (180).

SUMMARY OF ARGUMENT.

The decision of this Court on the former review of this case was that no statute, judicial doctrine, or rule of the Commission precluded the respondents, as officers and directors of Federal and Utility Operators, from purchasing stock in Federal during the period while successive plans of reorganization were pending before the Commission. The opinion pointed out that the record was "utterly barren" (109) of any showing of misuse by the respondents of their position as reorganization managers. It was held that the former decision of the Commission, denying participation to the respondents on the same basis as other stockholders, could not be sustained (111). *Securities and Exchange Commission v. Chenery Corporation et al.*, 318 U. S. 80.

Now the Commission has "reaffirmed" its former decision on exactly the same record. No additional testimony has been taken. The Commission disavows the existence of any proof of "conscious wrongdoing" (149), and, as before, the Commission bases its decision solely on "the character of the conflicting interests" (149). The only difference between the decisions is that the former decision was based on an erroneous conception of equity while the present decision is based on a conception of the Commission's administrative powers which we contend is equally erroneous.

We contend that the Commission's present order, denying equal participation to the respondents, is not supported by evidence or even by the findings of the Commission, and that it is wholly arbitrary. It is based not upon facts, but upon "doubts" (149).

We contend that any power in the Commission to resolve problems of policy is legislative in its nature and should be exercised by the promulgation of regulations, prospective in their operation, which will serve as a fair warning to such persons as may come within their provisions.

This retroactive order of the Commission would, in fact, deprive the respondents of property without due process, since an important attribute of their stock is the contractual right to be treated on a parity with other stockholders. Whether the Commission purports to act in an administrative, legislative, or judicial capacity, we contend that it has no power under the statute to enter an order the effect of which is to change existing law in such a way as to deprive the respondents of normal property rights.

ARGUMENT.

1.

The Record, Findings, Decision and Order Are Essentially the Same as on the Prior Review.

By the order entered February 7, 1945, and now under review:

1. The Commission denied an application to amend the plan of reorganization to treat stock of these respondents on the same basis as other preferred stock (170).

2. The Commission reapproved its order of September 24, 1941, which treated the stock of these respondents on a different basis from other stock (170).

In its effect, the order entered by the Commission on February 7, 1945, is exactly the same as the order entered on September 24, 1941.

The record on which the order of February 7, 1945, is based is exactly the same as the record on which the order of September 24, 1941, was based. No additional evidence

was introduced on behalf of the Commission, or on behalf of any of the parties to the proceeding. Although two hearings were had before the Commission, these involved only the presentation of argument by counsel on the record already existing.

The Commission's findings have been completely rewritten, but there is no material change in the facts as found. It is true that the Commission has attempted to avoid the effect of its former concession of good faith, but the Commission has made no finding to the contrary. In its decision in 1941, the Commission had held that the respondents were "trustees" who had purchased trust property, that they must account for any profit on such purchases, and that

"* * * honesty, full disclosure and purchase at a fair price do not take the case outside the rule." (8 S. E. C. 893, 916-7)

The position of the Commission at that time was stated by the Court of Appeals as follows:

"The Commission's brief and argument in this court explicitly declare that the conclusion to outlaw this stock is not 'predicated on any finding that petitioners defrauded or failed to make the fullest disclosure to the stockholders from whom they purchased the shares in question.' On the contrary, the Commission, very properly, admits that the transactions complained of were consummated without 'any ulterior purpose' and equally without any intention to profit personally 'in the consummation of the plan through having traded while the proceedings were pending.'

"* * * it is admitted that there was a full and free disclosure before any purchases were made, the exercise of the utmost good faith throughout." *Chenery Corporation v. Securities and Exchange Commission*, 128 F. (2d) 303, 306, 308.

And this Court said:

"* * * The Commission's determination can stand, therefore, only if it found that the specific transactions

under scrutiny showed misuse by the respondents of their position as reorganization managers; in that as such managers they took advantage of the corporation or the other stockholders or the investing public. *The record is utterly barren of any such showing. Indeed, such a claim against the respondents was explicitly disavowed by the Commission*" (109). *Securities and Exchange Commission v. Chenery Corporation*, 318 U. S. 80, 93 (Italics ours).

Now, however, the passage of more than three years and change in membership has dulled the Commission's original perception of the good faith of these respondents. In its opinion of February 7, 1945, the Commission now says that it never made a finding of "honesty, full disclosure and purchase at a fair price," and that this Court was mistaken in that regard (164, *fn.*). The Commission makes no finding on this point, and states its present position as follows:

"As we have already indicated, the personal integrity of these particular interveners is not a question at issue in this case. For obvious reasons we do not conceive it our function to try to guess whether a reorganization manager, faced with a choice of conducting the reorganization for the accomplishment of his own objectives or for the benefit of security holders generally, is the kind of man who would be likely to take one course and not the other." (163).

On this review therefore, as before, there is "a record utterly barren of any showing" that these respondents "misused their position" or "that they took advantage of the corporation, the other stockholders or the investing public". While the Commission has not again, "explicitly disavowed" such a claim, it has made no adverse finding on the point. The respondents are the same as when the case was here before, and the same acts by them are again under review, upon exactly the same record.

The decision of the Commission of September 24, 1941, was that stock which was acquired by these respondents during a period in which successive reorganization plans

were before the Commission should not be permitted to participate in the reorganization on an equal footing with other stock of the same class. The decision of the Commission of February 7, 1945, now under review is exactly the same. In fact the Commission's original order was "re-approved" (170).

2.

The Commission Has Misinterpreted the Decision of This Court.

The only differences in the Commission's two decisions are in the reasons advanced therefor. In the decision of September 24, 1941, the Commission professed to decide the case according to principles applied by courts of equity. The present decision professes to be based on the "special experience" of the Commission. The Commission now undertakes to decide the case on the following theory:

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate we are directed to re-examine the case and to decide on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified." (130).

We respectfully submit that this construction of the former opinion is wholly erroneous. The Commission ignores the following decisive language of this Court:

"* * * But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized

to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11(e), promulgated new general standards of conduct. * * *

Let us examine this language word by word, so that there may be no question as to its meaning:

“before transactions otherwise legal can be outlawed or denied their usual business consequences”

Clearly that means that before the purchases of stock by these respondents, which the Court ultimately found were “otherwise legal”, could be outlawed (as had been done by Commission's decision) or denied their usual business consequences (as had been done by the Commission)

“they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority.”

Note the use of the word “prescribed”, derived from “*prae*” before, and “*scribere*” to write, that is “written before.”

“Congress itself did not proscribe the respondents' purchases of preferred stock in Federal.”

This clearly means that the statute itself did not forbid the purchases by these petitioners.

“Established judicial doctrines do not condemn these transactions.”

This is clear enough.

“Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11 (e), promulgated new general standards of conduct.”

This certainly is clear. Section 11(e) of the Public Utility Holding Company Act of 1935 provides:

"In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission * * *"

In the opinion there were at least three references to the rule-making powers of the Commission. Thus the Court said,

(1) "The Commission dealt with this as a specific case, and not as the application of a general rule formulating rules of conduct for reorganization managers." (103).

(2) "Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different." (108).

(3) "Nor has the Commission, acting under the rule-making powers delegated to it by Sec. 11(e), promulgated new general standards of conduct." (109).

Certainly this language, used three times, could not have been "merely illustrative", as is now suggested by counsel for the Commission (brief p. 19).

The language of this Court in that opinion is just as applicable now as it was then. The purchases made by the respondents do not "fall under the ban" of any "standards of conduct prescribed by an agency of government." And it is impossible for the Commission to bring them under any such ban, for when the purchases were made they were not forbidden by any act of Congress, nor by established judicial decisions, nor by any rule promulgated by the Commission.

The Commission's Order is Not Supported by the Findings of Fact or by the Evidence. It is Wholly Arbitrary.

The application and declaration of Federal Water and Gas Corporation were filed under Section 7 (a) of the Act, and under Section 7 (d) (6) and 7 (e) thereof the Commission "shall permit" such a declaration to become effective unless the Commission finds that it "will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant, or is otherwise detrimental to the public interest or the interest of investors or consumers." In making its decision the Commission is also permitted to apply the standards of Section 11 (e) of the Act and to determine whether the plan is "fair and equitable." (107). These were the "statutory questions" which the Commission purported to resolve. (147).

The Commission, however, cannot be arbitrary in making its decision. Its determination must be a reasonable one, based on findings of fact, and these findings of fact must be supported by evidence. As the Commission admitted in this case, the statutory questions must be considered "in the light of the record before us." (147)

In the present case the error lies in the complete absence of any findings or evidence on which the Commission's order can reasonably be based.

The decision of the Commission reduced to its simplest terms is this:

Finding: The respondents were officers and directors of Federal and of Utility Operators. During the period when successive plans were under consideration by the Commission, the respondents purchased preferred stock of Federal.

Conclusion: Because conflicting interests subjected the respondents to temptation, the preferred stock so purchased by them should not be allowed to participate in the reorganization on an equal basis with other stock of the same

class, but should be surrendered to the corporation at cost plus four per cent.

The Commission has suggested that while a reorganization is under consideration the management has an opportunity to manipulate the reorganization and to influence the market for its own gain; but the Commission has made no finding that anything of the sort was done in this case.

The Commission has suggested that "doubts . . . remain unresolved" (149). But there is no doubt what the evidence is, and there is no conflict in the evidence. The reasons which prompted the respondents to purchase the stock are set forth in the Commission's findings, and have been quoted in this brief (pp. 6-8). They were fair and honest reasons. The Court of Appeals summed up the situation as follows:

"Accordingly, we had then, as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless, to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives." (174)

When the case was here before this Court said,

"The Commission's determination can stand, therefore, only if it found that the specific transactions under scrutiny showed misuse by the respondents of their position as reorganization managers, in that as such managers they took advantage of the corporation or the other stockholders or the investing public. The record is utterly barren of any such showing." (109).

The record is still utterly barren of any such showing. No additional evidence has been introduced. The Commission has not found, and there is no evidence to warrant a finding, that the respondents took advantage of the corporation,

the other stockholders, or the investing public. On the contrary, all of the evidence is to the effect that their reasons for purchasing the stock were legitimate,* and that the respondents were fair and open in all their dealings.

Nevertheless the Commission held,

"Ultimate Conclusion

"* * * we are unable to find that the plan if amended as proposed would be 'fair and equitable to the persons affected thereby' within the meaning of Section 11(e) of the Act. It is our view that the plan so amended would involve the issuance of securities on terms 'detrimental to the public interest and the interest of investors' forbidden by Sections 7 (d) (6) and 7 (e) of the Act, and would result in an unfair and inequitable distribution of voting power within the meaning of the latter section. Thus we are unable to approve the amended plan." (149).

We contend that this conclusion is not supported by any evidence, or even by the Commission's findings. Why would it not be "fair and equitable to the persons affected thereby" to treat the preferred stock purchased by these respondents during the period of reorganization on the same basis as preferred stock held by others? Why would it be "detrimental to the public interest and to the interest of investors" to do so? Why would it result in an unfair and inequitable distribution of voting power? We have looked in vain for any evidence, or even for any finding of fact, which supports these conclusions.

The Commission has not found as a fact that these respondents depressed the market price of the stock in order to make favorable purchases, and there is no evidence on which the Commission could have made such a finding. The purchases were in the open market at market prices (58), and would tend rather to support the market than to de-

* This Court observed on the last review that "The respondents frankly admitted that their purpose in buying the preferred stock was to preserve their interests in the company" (101).

press it. There is no evidence of dissatisfaction on the part of any seller. One large seller in fact stated affirmatively that he was "delighted to make the trade" and that it had been "most satisfactory" (58).

Nor did the Commission find that there was anything about the character of these respondents from which a conclusion could be drawn that it was "in the public interest or the interest of investors" to bar them from exercising voting power in the corporation. On the contrary the Commission has stated that "the personal integrity of these particular interveners is not a question at issue" (163).

The Commission states the following as the basis for its decision:

"We are led to this result not by proof that the interveners committed acts of conscious wrongdoing, but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration." (149).

Thus the Commission's decision does not even purport to be based on the facts of this case, but constitutes rather the establishment of a new legal standard of conduct and its application to transactions completed some years ago. In spite of the decision of this Court, the Commission still contends that equitable principles relating to trustees of express trusts require the promulgation of such a standard.

In reversing the order of the Commission the Court of Appeals said,

"Certainly, a reasoned conclusion must be based on evidence, and may not be pitched alone on unresolved doubts, nor upon weaknesses or selfishness which the Commission believes is inherent in human nature. The

* See footnote to Commission's present decision in which the Commission, likening itself to a court of equity, quotes at length from Lord Eldon's decision as to trustees in *Ex parte Lacey*, 6 Vesey 625, 626a, 628 (1803) (160).

construction advanced by the Commission would permit it to exercise a power of disapproval free of judicial review, and the notice and hearing required by the statute would become an empty form. The Commission, free of the inhibitions imposed by the particular facts, would be left to roam the widest possible area of authority influenced and impelled only by its own doubts.

"Thus considered, it is apparent that the Commission has made its present order without reliance upon such evidence or findings as would warrant our affirmation."

4

The Commission's Order Amounts to Retroactive Legislation Depriving the Respondents of Property Without Due Process of Law.

The retroactive feature of the Commission's present decision is particularly arbitrary. It is contrary to the fundamental tenets of American jurisprudence, and does violence to our sense of justice, that a person who acted in conformity with the law as it appeared at the time of his act, should later be penalized.

That the Commission now is well aware that prohibitions involving the promulgation of new policies should be prospective in their operation is shown by its recent handling of a similar problem in *Western Light and Telephone Company, Holding Company Act Release No. 5902 (July 2, 1945)* where a policy to preclude participation in competitive bidding by a person employed as financial adviser by the issuer was announced for the future, but was not applied in the case then under consideration. If the Commission had acted in the present case as it did in the *Western Light and Telephone* case it would have permitted the stock of the respondents to participate equally with other stock but would have announced a different policy for future cases. Instead the Commission created a prohibition, not hereto-

fore known to common law, equity, or statute; and applied it retroactively to these respondents alone.

Counsel for the Commission cite *Addison v. Holly Hill Fruit Products, Inc.*, 322 U. S. 607 (1944), as sanctioning retroactivity. In that case, the retroactive order was decreed only because of the necessities of the situation. Thus the Court said:

“ . . . To be sure this will be a retrospective judgment, and law should avoid retroactivity as much as possible. But other possible dispositions likewise involve retroactivity, with the added mischief of producing a result contrary to the statutory design.” (p. 620)

And in the dissenting opinion we find:

“Retroactivity is not favored in law. For this there are sound reasons, in some cases constitutional ones. Cf. *Forbes Pioneer Boat Line v. Board of Commissioners*, 258 U. S. 338; *Ochoa v. Hernandez y Morales*, 230 U. S. 139. There are few occasions when retroactivity does not work more unfairly than fairly. Congress, the state legislatures and the courts apply the principle sparingly, even where they may. Cf. *Graham & Foster v. Goodcell*, 282 U. S. 409; *United States v. Heinszen & Co.*, 206 U. S. 370. Seldom if ever therefore may administrative or executive authority to apply it be inferred from legislation not expressly giving it. Compare *Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co.*, 284 U. S. 370; *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110 . . .” (p. 641)

Thus the Court was in agreement that “the law should avoid retroactivity as much as possible.”

The Commission seeks to avoid criticism of the retroactive nature of its order by stating that:

“ . . . the decision of any case of first impression may have an effect not foreseen or foreseeable.” (166f.)

Of course, courts are always applying principles of law and equity to new situations and are thus developing new principles. Such results are in fact reasonably foreseeable.

But that is not the situation here, for this Court has expressly held in this very case that no principle of common law or equity has been violated by the respondents. The Commission, as the body created by Congress to administer the Act, has a further power not granted to courts, the power to promulgate regulations of general application. In the words of this Court, the Commission may resolve "problems of policy" by "prohibitions unconcerned with the fairness of a particular transaction". The nature of such a regulation might not be foreseeable.

But such delegated power to resolve problems of policy is legislative. Where a new standard is to be created by the Commission, ordinary justice as well as a reasonable interpretation of the statute* requires that such a standard be put into effect by a regulation prospective in its operation, so that it will serve as a fair warning to such persons as may come within its provisions.

The recent Administrative Procedure Act, Pub. L. No. 404, 79th Cong., 2nd Sess. (June 11, 1946), is a manifestation of the concern of Congress that substantive rules be published before taking effect. By implication at least the enactment of this statute "To improve the administration of justice by prescribing fair administrative procedure" was a condemnation of retroactive action by administrative agencies.

The Fifth Amendment of the Constitution of the United States provides:

"No person shall * * * be deprived of life, liberty, or property, without due process of law * * *"

* The general intent of Congress to avoid retroactivity is indicated in Section 20(d) of the Act, which says:

"* * * No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

The preferred stock of these respondents was property protected by this Amendment, and an important attribute of that property was the contractual right held by the respondents, as against the corporation and the other stockholders, to be treated always on a parity with such other stockholders. This is the common law in Delaware, where the corporation was organized, *Eagleson v. Pacific Timber Company*, 270 Fed. 1008, as in other states, and is recognized by the federal courts. *Fletcher, Cye. Corp.* (Perm. Ed.) Sec. 7296.

"Due process of law" is violated by arbitrary deprivation of property, or by arbitrary "taking of one man's property and giving it to another." *Ochoa v. Hernandez*, 230 U. S. 139, 161.

Here the order of the Commission arbitrarily takes the property of the respondents and gives it as a windfall to the surviving corporation. The Commission purports to act by reason of its power to determine whether the plan submitted met the tests imposed by Sections 7 and 11 of the Act, but in reality the Commission has exercised an assumed power to punish these respondents for acts which the Commission contends have violated a standard never before promulgated by the Commission or by any body, legislative or judicial.

The Commission's decision violates the Fifth Amendment by reason of its retroactive effect,* for it has repeatedly been held that neither the legislature nor the courts can change the law retroactively to the detriment of contractual rights.

Since the Commission purports now to be acting in its administrative capacity and as an arm of Congress, it is appropriate first to consider decisions relating to legislation. In many such cases statutes have been declared unconstitutional because they have retroactively affected

* The respondents assigned this as one of their points in the Court of Appeals (12), but the court did not find it necessary to pass on it.

property rights. *Ettor v. Tacoma*, 228 U. S. 148; *Ochoa v. Hernandez y Morales*, 230 U. S. 139; *Nichols v. Coolidge*, 274 U. S. 531; *Blodgett v. Holden*, 275 U. S. 142, mod. 276 U. S. 594; *Unfermyer v. Anderson*, 276 U. S. 440; *Coolidge v. Long*, 282 U. S. 582; *Treigle v. Acme Homestead Assn.*, 297 U. S. 189; *Wood v. Lovett*, 313 U. S. 362. Some of these decisions involved state legislation in violation of the Fourteenth Amendment, but the principle of violation of "due process" is the same.

A good example is *Treigle v. Acme Homestead Association*, *supra*. There a statute was held unconstitutional which abrogated the right of stockholders of a building association to have fifty per cent of the receipts of the Association set apart to pay withdrawing members. The new statute left the amount to the discretion of the directors. The Court said:

"... Such an interference with the right of contract cannot be justified by saying that in the public interest the operations of building associations may be controlled and regulated, or that in the same interest their charters may be amended. . . (196)

"As we have pointed out, the questioned sections deal only with private rights, and are not adapted to the legitimate end of conserving or equitably administering the assets in the interest of all members. They deprive withdrawing members of a solvent association of existing contract rights, for the benefit of those who remain. We hold the challenged provisions impair the obligation of the appellant's contract and arbitrarily deprive him of vested property rights without due process of law." (197, 198).

This language can well be applied to the present case, where the Commission has attempted to abrogate contract rights, lawful when acquired, under the guise of acting on a declaration filed pursuant to Section 7 of the Act.

Judicial decision also may be violative of the due process clause, if it overturns existing law which was relied upon

in the acquisition of property. Thus in *Gelpcke v. Dubuque*, 1 Wall. (68 U. S.) 175, it was contended that decisions of the State of Iowa which supported the validity of a bond issue, had been overruled by a later decision of that state. The Supreme Court held that rights acquired upon the strength of established judicial construction of a statute could not be lost by a new construction. The Court said:

"However we may regard the late case in Iowa as affecting the future, it can have no effect upon the past. The sound and true rule is, that if the contract, when made, was valid by the laws of the State as then expounded by all departments of government, and administered in its courts of justice, its validity and obligation cannot be impaired by any subsequent action of legislation, or decision of its courts altering the construction of the law."

"The same principle applies where there is a change of judicial decision as to the constitutional power of the legislature to enact the law. To this rule, thus enlarged, we adhere. It is the law of this court. It rests upon the plainest principles of justice. To hold otherwise would be as unjust as to hold that rights acquired under a statute may be lost by its repeal. *The rule embraces this case.*" (Italics ours.)

To the same effect are *Havemeyer v. Iowa Co.*, 3 Wall. (70 U. S.) 294; *Olcott v. Supervisors*, 16 Wall. (83 U. S.) 678; *Douglass v. County of Pike*, 101 U. S. 677; *County of Ralls v. Douglass*, 105 U. S. 728; *Green Co. v. Conness*, 109 U. S. 104; *Muhlker v. N. Y. & Harlem Railroad Company*, 197 U. S. 544. See also *Stimson Retroactive Application of Law—A Problem in Constitutional Law*, 38 Mich. L. Rev. 30.

Certainly Congress has given the Commission no authority to make any order that has the effect of depriving these respondents of property without due process of law, and we contend that the Commission's order has that effect. Whether the Commission purports to act in an administrative, legislative, or judicial capacity, we contend that it has no power to enter such an order.

CONCLUSION.

The respondents therefore pray that the judgment of the United States Court of Appeals for the District of Columbia be affirmed.

Respectfully submitted,

SPENCER GORDON,
Attorney for Respondents.

COVINGTON, BURLING, RUBLEE,
ACHESON & SHORB,
Washington, D. C.

APPENDIX OF STATUTES.

Public Utility Holding Company Act of 1935.*

Sec. 6. (a) Except in accordance with a declaration effective under section 7 and with the order under such section permitting such declaration to become effective, it shall be unlawful for any registered holding company or subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, directly or indirectly (1) to issue or sell any security of such company; or (2) to exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of such company.

Sec. 7. (a) A registered holding company or subsidiary company thereof may file a declaration with the Commission, regarding any of the acts enumerated in subsection (a) of section 6,

(d) If the requirements of subsections (c) and (g) are satisfied,** the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

(e) If the requirements of subsection (g) are satisfied,** the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security, unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

* 49 Stat. 803, 15 U. S. C. Sec. 79.

** Subsections (c) and (g) are not material.

Sec. 11(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public utility company.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commis-

sion shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan therefore approved by the court and the Commission, the assets so possessed.

• • • • •

Sec. 20(d) • • • No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

FILE COPY

Office - Supreme Court, U. S.

FILED

DEC 6

Supreme Court of the United States

OCTOBER TERM, 1946

No. 82

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

FEDERAL WATER AND GAS CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE DISTRICT OF COLUMBIA

**BRIEF FOR FEDERAL WATER AND GAS
CORPORATION**

ALLEN S. HUBBARD

*Attorney for Federal Water and
Gas Corporation*

HUGHES, HUBBARD & EWING
New York, N. Y.

TABLE OF CONTENTS

	PAGE
Opinions below.....	1
Jurisdiction	1
Statement	2
Summary of Argument.....	5
Argument.....	7
FIRST: Federal Water and Gas Corporation is a "party aggrieved" by the Commission's order.....	7
SECOND: The Commission misconstrued the statutory standard "fair and equitable" in Section 11(e) of the Holding Company Act.....	7
THIRD: The Commission misconstrued the statutory standard "detrimental to the public interest or the interest of investors or consumers" in Section 7 of the Holding Company Act.....	14
FOURTH: The Commission misconstrued the opinion of this Court and failed to give effect to its man- date	15
FIFTH: The grounds upon which the Commission based its decision were pertinent to an inquiry as to the advisability of promulgating a rule with re- spect to officers' and directors' purchases of stock. They afford no basis for the Commission's adminis- trative decision disposing of the interveners' prop- erty and denying Federal Water and Gas Corpora- tion's application for leave to amend the merger agreement	28
CONCLUSION	35
*Appendix of Statutes and Rules.....	36
Citations	ii

Citations

CASES:

PAGE

<i>American Power & Light Co. v. S. E. C.</i> , decided Nov. 25, 1946	23
<i>Chicago Junction Case</i> , 264 U. S. 258.....	33
<i>Ecker v. Western Pac. R. Co.</i> , 318 U. S. 448.....	11
<i>Federal Power Commission v. Pacific Co.</i> , 307 U. S. 156	7
<i>Group of Investors Inc. v. Milwaukee R. Co.</i> , 318 U. S. 523.....	11
<i>Interstate Commerce Commission v. Louisville & Nashville R. Co.</i> , 227 U. S. 88.....	32, 33
<i>Lownsbury v. S. E. C.</i> , 151 F. (2d) 217.....	11
<i>Meinhard v. Salmon</i> , 249 N. Y. 458.....	17
<i>Morgan, Stanley & Co. v. S. E. C.</i> , 126 F. (2d) 325..	31
<i>Okin v. S. E. C.</i> , 145 F. (2d) 206.....	11
<i>Otis & Co. v. S. E. C.</i> , 323 U. S. 624.....	8, 10, 11, 12
<i>Phillips v. S. E. C.</i> , 153 F. (2d) 27.....	11
<i>Prentis v. Atlantic Coast Line</i> , 211 U. S. 210.....	30
<i>Reconstruction Finance Corp v. Denver & Rio Grande R. Co.</i> , 90 L. Ed. 1134.....	11
<i>Securities and Exchange Commission v. Chenery Corporation, et al.</i> , 318 U. S. 80.....	3, 10, 15-27

STATUTES:

Administrative Procedure Act, Pub. L. No. 404, 79th Cong. 2nd Sess. (June 11, 1946).....	31
Public Utility Holding Company Act of 1935, 49 Stat. 803 (15 U. S. C. Sec. 79, et seq.)	
Sec. 7(a) 2	14
7(d) (6)	4
7(e)	4
7(g)	15
11(b)	14, 33
11(e)	4, 6, 8, 10, 11, 12, 13

MISCELLANEOUS

House Report No. 1903, 74th Cong., 1st Sess.	22
Senate Report No. 621, 74th Cong., 1st Sess.	21, 22, 23, 28
Moody's Public Utilities (1946).....	5

Supreme Court of the United States

OCTOBER TERM, 1946

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

FEDERAL WATER AND GAS CORPORATION

No. 82

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR FEDERAL WATER AND GAS CORPORATION

Opinions Below

The opinion of the Court of Appeals (R. 172-80) is reported in 154 F. (2d) 6.

The findings and opinion of the Commission which accompanied its order of February 7, 1945 (R. 128) are reported in S.E.C. Holding Company Act Release No. 5584. The prior opinions of the Commission and the courts are reported in 8 S.E.C. 893; 10 S.E.C. 200; 128 F. (2d) 303 and 318 U.S. 80.

Jurisdiction

The judgment of the Court of Appeals was entered February 4, 1946 (R. 181). The petition for writ of certiorari was filed April 8, 1946 and granted May 13, 1946 (R. 184-185). This Court appears to have juris-

diction under Section 240(a) of the Judicial Code, as amended, which is made applicable by Section 24(a) of the Public-Utility Holding Company Act of 1935.

Statement

The interveners own certificates for 11,598 shares of preferred stock of Federal Water Service Corporation (R. 124) which they purchased during the period from March 8, 1937 to June 10, 1940 (R. 82, 83) in the open market, except for the acquisition by Chenery Corporation of 2700 shares of preferred stock from a securities dealer by exchanging therefor \$100,000 par value of debentures of Federal Water Service Corporation on June 10, 1940 (R. 138).


The Commission by order entered on September 24, 1941 (10 S.E.C. 200) approved a merger agreement which provided that these shares owned by the interveners be surrendered to Federal Water and Gas Corporation for cost plus four per cent interest to the date of the merger agreement, except that the price for shares owned by certain interveners who had realized profits on sales was reduced so as to obtain for the corporation such profits (R. 120, 121). The decision was based upon the ground that the interveners had violated their fiduciary duties as these duties were established by courts of equity in purchasing preferred stock during a period when a reorganization plan for Federal Water Service Corporation was on file with the Commission. Upon review of the order of the Commission by the interveners, the Court of Appeals for the District of Columbia held that it should be set aside (128 F. (2d) 303) and this Court on certiorari, as

we read the opinion, affirmed the order, directing the Court of Appeals to remand the cause to the Securities and Exchange Commission for such further proceedings as may be appropriate, not inconsistent with the opinion of this Court (*Securities and Exchange Commission v. Chenery Corporation, et al.*, 318 U.S. 80; R. 98-111).

Federal Water and Gas Corporation thereupon applied to the Commission for leave to submit to its stockholders resolutions amending and correcting the merger agreement so as to give to the interveners the right to exchange their outstanding certificates of Federal Water Service Corporation stock for certificates of Federal Water and Gas Corporation and otherwise restore to the interveners the rights of which they had been unlawfully deprived by the Commission's order (R. 118-126).

The Commission interpreted the opinion of this Court as having sustained the Commission's power to reach the result which the Commission reached in its prior order, but as requiring the Commission to place its decision on the basis of its administrative experience instead of upon the basis of equity precedents (R. 130).

Purporting to exercise the authority which the Commission held this Court had given to it, the Commission held that if the interveners were permitted to purchase stock while a plan of reorganization was on file with the Commission, they might be tempted to abuse their fiduciary duties in order that they might purchase stock (R. 157-164); that the Commission could not enter into any inquiry as to the motives of the interveners in purchasing stock (R. 164); that it was the duty of the Commission to prevent the possibility of temptation to abuse fiduciary duties during the period when a reorganization plan was on file



with the Commission (R. 165, 166). Because of an alleged conflict of interests, the Commission held that it had doubts (R. 149) which prevented an affirmative finding of fairness and equity under Section 11(e) and for the same reasons, the Commission made the affirmative findings under Sections 7(d)(6) and 7(e) that the proposed amendment was "detrimental to the public interest and the interest of investors" (R. 149).

The Court of Appeals unanimously reversed the order of the Commission upon the ground that the findings of the Commission did not sustain its administrative conclusions. The Court of Appeals also interpreted the opinion of this Court as holding that if a new standard of fiduciary duty for officers and directors and controlling stockholders is to be promulgated by the Commission, it ought to be by rule having a prospective operation. The Court said (R. 180):

"* * * What we do say is that, without such a rule, of which notice is given so that all may know of its existence, transactions in themselves fair and just and honest and in accord with traditional business practices, and which Congress itself did not proscribe, and which judicial doctrines do not condemn, may not properly be outlawed or denied their ordinary effect."

The only facts contained in the record which appear to be material from the standpoint of the Commission's opinion are the following:

The interveners were officers or directors of Federal Water Service Corporation and Utility Operators Company and were therefore fiduciaries. Federal Water Service Corporation registered with the Commission on

November 8, 1937 under the Public Utility Holding Company Act and on the same day filed a plan of reorganization. Between November 8, 1937 and June 10, 1940 the interveners purchased shares of preferred stock of Federal Water Service Corporation at prices which the Commission held would give to the interveners a profit if, in the reorganization plan for Federal Water Service Corporation, they received common stock for their shares of preferred stock on the same basis as other stockholders of the same class. There was no specific finding as to the amount of the profit. The Commission found that the book value of the new common stock which would be issued in exchange for stock costing \$328,347 would be \$1,162,000; but the Commission also found that the probable market value for the new common stock was approximately \$5 per share or an aggregate of \$395,385 as compared with the aggregate cost of \$328,347 for the stock (R. 139). The record does not show the market prices of the new common stock following the consummation of the merger.*

Summary of Argument

The Commission, in denying the application of Federal Water and Gas Corporation for leave to amend the merger agreement, made the following errors of law:

*Moody's Ten-year Range for Public Utility Stocks (Moody's Public Utilities (1946) a71), quotes the low and high for the years 1941-45 inclusive as follows:

1941.....	5 $\frac{7}{8}$	7 $\frac{1}{4}$
1942.....	4	8 $\frac{7}{8}$
1943.....	10 $\frac{1}{4}$	13 $\frac{3}{8}$
1944.....	12	15 $\frac{1}{2}$
1945.....	17 $\frac{1}{2}$	22 $\frac{1}{2}$

1. It misconstrued the statutory standard "fair and equitable" in Section 11(e) of the Holding Company Act. This phrase means what it has always meant in a reorganization context that there shall be an equivalence between the rights surrendered and those received in reorganization.

2. It misconstrued the statutory standard "detrimental to the public interest or the interest of investors or consumers" in Section 7 of the Holding Company Act. Section 7 requires plans of reorganization to be in accordance with State law and the phrase cannot be construed so as to require a corporation to violate the rights of any stockholders in order to obtain the approval of the Commission.

3. It misconstrued the opinion of this Court. It held that this Court authorized it to reach the result which it had reached provided it placed its decision on the basis of its administrative experience instead of on the basis of equity precedents. This was error. This Court did not authorize the Commission to reaffirm its order. On the contrary, this Court held "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority." The Court held that the interveners had not violated their fiduciary duties in purchasing preferred stock while a plan of reorganization was on file with the Commission as those duties were established by courts of equity. There was no other standard of fiduciary duty. This Court further held that the order could not be sustained as an exercise of administrative competence because it did not have any of the characteristics of an appropriate exercise of adminis-

trative competence. If the Commission had passed a rule which had been violated, the case would have been different.

4. It made an administrative decision which was not based upon the facts in the record but upon the invention of a new policy with respect to officers' and directors' and controlling stockholders' purchases of stock. If the policy is desirable, it can only be made effective through the exercise of the legislative power of the Commission. The application of a new policy as to officers' and directors' purchases in order to outlaw past transactions in a reorganization was beyond the power of the Commission. It was also arbitrary and capricious and constituted an abuse of discretion, if it was in an area where Congress authorized the Commission to exercise discretion.

Argument

FIRST

FEDERAL WATER AND GAS CORPORATION IS A "PARTY AGGRIEVED" BY THE COMMISSION'S ORDER.

The Commission's brief (p. 17) notes but does not argue the question whether Federal had standing to file a petition for review as a "person or party aggrieved" by the Commission's order within the meaning of Section 24(a) of the Holding Company Act. There is no merit in the suggestion (*Federal Power Commission v. Pacific Co.*, 307 U. S. 156).

SECOND

THE COMMISSION MISCONSTRUED THE STATUTORY STANDARD "FAIR AND EQUITABLE" IN SECTION 11(c) OF THE HOLDING COMPANY ACT.

It is impossible to determine whether the findings of an administrative agency meet the tests supplied by a statutory

standard without determining the meaning of the statutory phrases relied upon by the agency as the source of the power which it is exercising. Here the phrase principally relied upon by the Commission is "fair and equitable" in Section 11(e) of the Public Utility Holding Company Act. It is submitted that this phrase in the Act means what it has always meant in a reorganization context, that there shall be a fair equivalence between the rights surrendered and those received in the reorganization. Where the reorganization takes the form of a reclassification of stock, all stock of the same class must be treated in the same way.

In this case it is submitted that the Commission never had any discretion other than to make a tentative decision of a question of law. Was the fact that the interveners purchased stock while a plan of reorganization was on file with the Commission a sufficient reason in law to justify the corporation in treating this stock differently from other stock in a "fair and equitable" reorganization under the Holding Company Act?

In *Otis & Co. v. Securities and Exchange Commission*, 323 U. S. 624, the question was whether a plan of reorganization under Section 11(e) of the Act was "fair and equitable" to preferred stockholders when, pursuant to order of the Commission, the company was liquidated and the preferred stockholders did not receive new securities having a market value equal to the liquidating preference of the old. The question which divided the Court was whether the charter terms with respect to dissolution "voluntary or involuntary" applied to a dissolution made pursuant to Commission order under the Holding Company Act. All of the justices of this Court concurred in the view that the question presented as to the rights of the stock-

holders *inter sese* was one of law and that the phrase "fair and equitable" had the meaning always given to it in a reorganization context. Mr. Justice Reed said (p. 633):

"We reach the conclusion that the Securities and Exchange Commission applied the correct rule of law as to the rights of the stockholders *inter sese*." (p. 634):

"Like the bankruptcy and reorganization statutes, the Public Utility Holding Company Act, in providing that plans for simplification be 'fair and equitable,' incorporates the principle of full priority in the treatment to be accorded various classes of security interests. This right to priority in assets which exists between creditors and stockholders, exists also between various classes of stockholders. When by contract as evidenced by charter provisions one class of stockholders is superior to another its claim against earnings or assets, that superior position must be recognized by courts or agencies which deal with the earnings or assets of such a company. Fairness and equity require this conclusion."

Chief Justice Stone, in a dissenting opinion in which Justices Roberts and Frankfurter concurred (p. 648), agreed as to the fixed meaning of the phrase "fair and equitable" in Section 11(e), stating:

"We think no other construction of § 11(e) of the present Act can be sustained. Neither the context of the statute nor the legislative history suggests any other. The Commission hints at no reason for not giving these terms of art, 'fair and equitable,' other than their long settled and hitherto accepted meaning."

The *Otis* case came to this Court under Section 25 of the Public Utility Holding Company Act on certiorari to review the decision of the Court of Appeals for the Third Circuit affirming the order of the United States District Court of Delaware entered in an enforcement proceeding under Section 11(e). The corporation and the Commission were aligned on one side and Otis & Co. was on the other, claiming that the corporation had applied an erroneous rule of law by failing to recognize its legal rights as fixed by the certificate of incorporation. This Court considered Otis & Co.'s contention as raising a question of law for the independent judgment of this Court.

The *Chenery Corporation* case came to this Court under Section 24 of the Act, on certiorari to review the decision of the Court of Appeals for the District of Columbia on direct review of an order of the Commission. The corporation and the Commission were aligned on one side; the interveners on the other. The question was similar to that in the *Otis* case—whether the Commission had applied the correct rule of law in determining the rights of the stockholders of Federal Water Service Corporation, *inter sese*.

Perhaps the difference in procedure for review tended to obscure the fact that the legal questions before the Court of Appeals on direct review of an order of the Commission holding "fair and equitable" a plan of reorganization under Section 11(e) of the Act are the same as those presented to a district court in an enforcement proceeding under Section 11(e) following a determination by the Commission that a plan of reorganization is "fair and equitable."

Where a corporation intends to enforce an 11(e) reorganization plan in a federal court, the practice is for the Commission to condition the effectiveness of its order upon its approval by the District Court. Where this is done, the

Court of Appeals will not entertain a direct review of the order of the Commission under Section 24 but will require the parties claiming to be aggrieved by the order to oppose it in the district court and in the event of an adverse order by the district court to seek review under Section 25 of the Act. (*Okin v. Securities and Exchange Commission*, 145 F. (2d) 206 (C. C. A. 2, 1944); *Lownsbury v. Securities and Exchange Commission*, 151 F. (2d) 217 (C. C. A. 3, 1945)). On the other hand, where the corporation intends to put through its plan of reorganization under state law without an order of enforcement under Section 11(e), the review of the order of the Commission holding that the plan is "fair and equitable" is necessarily by the Court of Appeals and on such review the Court of Appeals will protect the rights of the parties aggrieved in the same manner as the district court in an enforcement proceeding in that Court (*Phillips v. Securities and Exchange Commission*, 153 F. (2d) 27 (C. C. A. 2, 1946)). Whatever the procedure for review, whether by the District Court in an enforcement proceeding or by the Court of Appeals under Section 24 the legal questions open to the Court are the same.

It was said in *Okin v. Securities and Exchange Commission*, *supra*, that the relationship of the Commission to the district court provided for in Section 11 is the same as that of the Interstate Commerce Commission to the district court in a railroad reorganization under Section 77 of the Bankruptcy Act. Such relationship was much considered by this Court in *Ecker v. Western Pacific R. Co.*, 318 U. S. 448 and *Group of Investors, Inc. v. Milwaukee R. Co.*, 318 U. S. 523. See, also, *Reconstruction Finance Corporation v. Denver and Rio Grande R. Co.*, 90 L. Ed.

p. 1134, dissenting opinion by Mr. Justice Frankfurter, rendered October 28, 1946.

In the railroad reorganization cases, the Court recognized the administrative competence of the Commission in dealing with such matters as valuation, capitalization, earnings, etc., but it determined for itself all legal questions such as were involved in the construction of mortgages in order that the plan might be fair and equitable. Mr. Justice Douglas in the *Milwaukee* case said with respect to the fair and equitable standard (p. 565):

"It is sufficient that each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered."

In his concurring opinion, Mr. Justice Roberts said (p. 577):

"Substantial equivalence satisfies the requirement of 'fairness and equity' in its legal sense as used in this setting."

Whenever the Commission under Section 11(e) of the Act finds that a plan proposed by a corporation is fair and equitable, it authorizes the corporation to "take" the property of all persons affected by the plan for the consideration set out in the plan. Unless Congress required the corporation to give a fair equivalent for the property taken, Section 11(e) of the Holding Company Act would be plainly unconstitutional, in that as so construed it would authorize the taking of property for private use without just compensation.

In the *Otis* case, Chief Justice Stone referred to the constitutional question, saying (p. 645):

"We cannot assent to the proposition advanced by the Commission that even though the priority stipulation was intended to be applicable to any kind of an involuntary liquidation, including one such as the present, the Commission can nevertheless override it. Such provisions for priority in a corporate charter constitute a contract among the stockholders, which is entitled to constitutional protection, *Bedford v. Eastern Building & Loan Assn.*, 181 U. S. 227; *Hopkins Federal Savings & Loan Assn. v. Cleary*, 296 U. S. 315; *Treigle v. Acme Homestead Assn.*, 297 U. S. 189, 194-6, impairment of which is not lightly to be attributed to Congress. No constitutional issue is raised here, but we find no provision of the statute which purports to confer on the Commission, in the exercise of its power to liquidate a corporation, any authority to set aside a lawful stipulation in which the stockholders have joined fixing their relative rights in the event of liquidation."

Here the Commission has reaffirmed its order of September 24, 1941 which authorizes the corporation by an appropriate proceeding under Section 11(e) of the Act to take the property of the interveners including profits on prior sales for cost plus four per cent. The interveners have violated no standard of fiduciary duty, no rule of the Commission and no statute in purchasing the stock. No statute limits their claims to cost plus four per cent. There is absolutely nothing upon which a court of equity could rely in justification for treating the interveners' stock differently from other stock in a "fair and equitable" reorganization.

The Commission in its opinion assumed that the phrase "fair and equitable" in Section 11(e) of the Holding Com-

pany Act authorized the Commission to apply to the determination of the application of Federal Water and Gas Corporation a subjective and in substance a non-reviewable test as to whether the interveners had sustained the burden, while the Commission for policy reasons foreclosed them from sustaining, of convincing the Commission that it was "fair and equitable" to allow them to participate in the reorganization on the same basis as other stockholders. It is manifest that the Commission did not use the phrase "fair and equitable" in the sense in which this phrase was used by Congress in requiring that all plans for compliance with Section 11(b) of the Holding Company Act must be "fair and equitable to the persons affected thereby."

THIRD

THE COMMISSION MISCONSTRUED THE STATUTORY STANDARD "DETRIMENTAL TO THE PUBLIC INTEREST OR THE INTEREST OF INVESTORS OR CONSUMERS" IN SECTION 7 OF THE HOLDING COMPANY ACT.

The controlling fact underlying the interpretation of the phrase "detrimental to the public interest or the interest of investors or consumers" is that any declaration by a corporation under Section 7 must conform to the requirements of state law.

Section 7(a)(2) provides that the declaration must include such information regarding "compliance with such State laws as may apply to the act in question as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest for the protection of investors or consumers." The rules of the Com-

mission give effect to this provision. Subsection (g) of Section 7 expressly prohibits the Commission from permitting a declaration regarding the act in question to become effective if a State commission informs the Commission that State laws applicable to the act in question have not been complied with.

Senate Report No. 621 (74th Cong., 1st Sess., p. 28) refers to subsection (g) as follows:

"Subsection (g) requires in all cases compliance with the applicable State laws."

Under Delaware Corporation Law, Federal Water Service Corporation was required to treat all stockholders of the same class in the same way. The phrase "detrimental to the public interest or the interest of investors or consumers" cannot be construed so as to require Federal Water Service Corporation to violate the rights of stockholders under state law in order that its declarations under Section 7 might become effective.

FOURTH

THE COMMISSION MISCONSTRUED THE OPINION OF THIS COURT AND FAILED TO GIVE EFFECT TO ITS MANDATE.

The Commission is not contending that this Court reserved decision as to what the Commission could do, if anything, in the exercise of its administrative competence. Its point is that this Court affirmatively held that the Commission was entitled to reaffirm the order that had been set aside if the Commission placed its decision on the basis of its administrative experience instead of on the basis of equity precedents.

The findings and opinion state (R. 130):

"As we understand the opinion of the Supreme Court, our determination of 1941 in this case was held to be unsupported by certain equity precedents on which we relied. And as we construe the Supreme Court's mandate, we are directed to re-examine the case on the facts, viewed in the light of that conclusion of the Court, whether our special experience in administering the legislative policy of the Act indicates a necessity for reaffirming our previous determination or whether, instead, our earlier ruling should be modified."

The Commission's brief states (p. 54):

"This Court expressly found that the Holding Company Act provided a firm basis for the power employed by the Commission in this case (R. 107-108; 318 U. S. 90-92) and in so doing, we submit, eliminated any real issue of improper retroactivity."

In referring to the statement of the Court of Appeals, following the opinion of this Court, that the Commission could not outlaw transactions that did not fall under the ban of any standard of conduct, the Commission said (p. 21):

"That determination is an oblique attack upon the meaning of this Court's mandate and opinion, which imposed no trammels on the Commission's powers and fully authorized the Commission to reach the result it has reached upon a clear and explicit statement of the administrative reasons justifying that result."

The Commission in its brief sets forth in lettered paragraphs the passages in this Court's opinion on which it

relies in support of its interpretation (pp. 24-32). We shall take up these passages in the order stated and comment upon them.

A. In this paragraph, (p. 24), the Commission refers to the holding of this Court that "a lax view of fiduciary obligations" would not be countenanced and that the conclusion that Federal's management were fiduciaries only began analysis as to the extent of their fiduciary obligations and the consequences of deviation therefrom. This paragraph is inconsistent with what the Commission did after remand. The Commission's opinion contains no analysis of the obligations of the interveners as fiduciaries. Nor did the Commission give effect to the fact that this Court upon full review of the record stated that there was no evidence of any violation by the interveners of any fiduciary duty owed by them to the corporation or to its stockholders.

This Court did not hold that it was possible to have a higher standard of fiduciary duty than that maintained by courts of equity. Justice Cardozo's statement in *Meinhard v. Salmon*, 249 N. Y. 458, "Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior" is the standard applied by courts of equity. For various reasons courts of equity treat officers and directors differently from trustees. Different standards of fiduciary duty are applicable because the facts are different. This Court held (R. 108-109) that the question whether directors or officers should be prohibited from buying or selling stock during reorganization presented a problem of policy.

B. The Commission here (pp. 24, 25) relies upon the fact that this Court interpreted its decision as having been

predicated upon a rule of law derived from equity precedents and that the review would be confined to the grounds upon which the Commission acted since "if an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to serve for an administrative judgment."

It is indisputable that the Commission intended its decisions of March 24 and September 24, 1941 to be construed as this Court construed them. The Commission did not purport to invent a new policy with respect to officers' and directors' purchases and apply it retroactively to the decision of the case. It did not purport to render a decision which violated the rights of the interveners as these rights existed under state law. It did not purport to exercise any power other than the power which a court of equity would exercise in passing upon a fair and equitable plan of reorganization. The decision of the Commission that it was fair and equitable and not detrimental for Federal Water Service Corporation to treat the 'interveners' stock differently from other stock was treated as an administrative decision. But there was "embedded" in the administrative decision the determination by the Commission of a question of law as to whether the interveners had violated their fiduciary duties as these duties were established by courts of equity. In this view, the only question of law before the Court was whether the Commission had correctly determined the fiduciary duties of the interveners as established by equity precedents. The question whether the Commission could invent a new policy with respect to officers' and directors' purchases of stock and apply the new policy retroactively to past transactions as a reason for

outlawing securities in a reorganization was in this part of the opinion deemed not subject to review because the Commission had not purported to make that kind of administrative decision. Subsequently in the opinion this Court dealt with the question whether the order of the Commission might be sustained as an exercise of "administrative competence". And this Court held that it could not be sustained on this ground because the opinion of the Commission did not have any of the characteristics of an appropriate exercise of administrative competence. It was not a rule and if given effect it would outlaw transactions which did not fall under the ban of any standard of conduct prescribed by Congress or the Commission. If there is any inconsistency between the statement of this Court that it would confine its review only to the grounds upon which the Commission acted and the fact that this Court considered whether the Commission's decision could be upheld as an appropriate exercise of administrative competence, the inconsistency does not help the Commission. If the Court had confined its opinion to the grounds upon which the Commission had acted, it would not have made any decision with respect to the power of the Commission to take appropriate action for the correction of reorganization abuses. Certainly the Court in holding that power was conferred upon the Commission to take some action with respect to purchases of stock could also explain the power held to have been granted by stating, in substance, that it should be exercised by rule having a prospective operation and could not be relied upon as support for the Commission's decision.

C. Under this subdivision (p. 25) the Commission quotes the conclusion (R. 106) "that the Commission was

in error in deeming its action controlled by established judicial principles". The verb "control" relates back to the beginning of the discussion (R. 103) as follows:

"On the contrary, the question before the Commission was whether the respondents, simply because they were reorganization managers, should be denied the benefits to be received by the 6,000 other preferred stockholders. Some technical rule of law must have moved the Commission to single out the respondents and deny their preferred stock the right to participate equally in the reorganization."

The inference is that unquestionably, in the view of the Court, the Commission would have permitted the interveners' stock to participate in the reorganization on the same basis as other stock unless the Commission had deemed its action controlled by a "technical rule of law".

The Commission also quotes (R. 105):

"Determination of what is 'fair and equitable' calls for the application of ethical standards to particular sets of facts but these standards are not static. In evolving standards of fairness and equity, the Commission is not bound by settled judicial precedents. Congress certainly did not mean to preclude the formulation by the Commission of standards expressing a more sensitive regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law."

The phrase "fair and equitable" in Section 11(e) is used in a reorganization context meaning that there shall be an equivalence between rights given up and those received in any plan to comply with Section 11(b) of the Holding Company Act. There is no other way to determine what

rights are required to be surrendered in order to conform to the policy of the law as set forth in Section 11(b) than by consulting and following settled judicial precedents.

The Court in this passage does not state that the Commission was authorized by Congress to disregard legal rights on ethical grounds. As we understand it what the Court had in mind was that the Commission might make new rules for the future as to officers' and directors' purchases.

D. This subdivision (pp. 26-27) relates to this Court's reference to the legislative history of Sections 7 and 11(e) of the Act and its conclusion that "Notwithstanding § 17(a) and (b), therefore, the Commission could take appropriate action for the correction of reorganization abuses found to be 'detrimental' * * *"

The Commission's brief in this Court in the *Chenery Corporation* case quoted from Senate Report No. 621 (74th Cong.; 1st Sess., p. 28) with respect to the terms set forth in subsection (f) of Section 7 as follows:

"are designed to give adequate protection to investors and consumers * * * and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection against the deleterious practices which have characterized certain holding-company finance in the past * * *"

There is nothing in this provision to indicate that the treatment by a corporation in a reorganization of stockholders whose rights are the same when judged in accordance with law was a "deleterious practice". The complete statement, however, of what Senate Report No. 621 said with respect to subsection (f) is as follows (p. 28):

"Subsection (f) sets forth the terms and conditions which the Commission may prescribe in an order permitting a declaration to become effective. These terms and conditions are designed to give adequate protection to investors and consumers in the course of future financing by companies in holding-company systems and to ensure that future developments are dictated by, and not detrimental to, the business needs of integrated units and are in accord with the underlying purpose of the legislation to give to investors and consumers full protection against the deleterious practices which have characterized certain holding-company finance in the past. They embrace matters of financial practices, the granting of preemptive rights, the giving of options, the taking of competitive bids, and similar matters which vitally affect the interest of the investor or the consumer in matters of more than local concern."

This quotation clarifies what was intended. The Senate bill, S. 2796, which accompanied Senate Report No. 621, contained very specific provisions with respect to types of securities which were to be permitted. It was these terms that were "designed to give adequate protection to investors or consumers in the course of future financing."

The House amended S. 2796 by striking out all of the Senate bill after the enacting clause (House Report No. 1903, 74th Cong., 1st Sess., p. 65) and in conference the terms of the Public Utility Holding Company Act of 1935 were agreed upon. The Conference Report (House No. 1903, 74th Cong., 1st Sess.) contained the following with respect to 7(f) (p. 67):

"The Senate Bill provides (Sec. 7(f)) that securities are to be issued subject to terms and conditions

to be prescribed by rules and regulations of the Commission and goes into detail with respect to what such terms and conditions may require. The House amendment contains no such provision. The substitute agreed to in Conference authorizes the Commission to prescribe terms and conditions to assure compliance with the conditions specified in the section."

This Court also quoted (R. 107) from an extract in the Commission's brief from Senate Report No. 621 with respect to Section 11 as follows:

"Under these subsections 11(d), (e), and (f), Commission approval of reorganization plans and supervision of the conditions under which such plans are prepared will make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities." *Id.*, p. 33.

The legislative history of Section 11(e) was before this Court in the *Otis* case and also again in *American Power & Light Co. v. Securities and Exchange Commission*, decided November 25, 1946. The history confirms only the view that the protection to be given to the public by Sections 11(d), (e) and (f) should be in accordance with legal standards applied by the Commission and the federal courts acting in cooperation.

It is submitted that what this Court meant by appropriate action for the correction of reorganization abuses was the passage of a rule having prospective operation prohibiting the purchase of stock by officers and directors and controlling stockholders on the ground that such purchases might have some relation to the reorganization

process under the Act. If the Court considered that reaffirmance of the order was "appropriate action for the correction of reorganization abuses", it would have sustained the order.

E. The Commission here (p. 27) attempts to deal with the reasons given by this Court for its decision that the Commission's order could not be sustained as an exercise of the Commission's administrative competence. This Court said (R. 108-109):

"Through its preoccupation with the special problems of utility reorganizations the Commission accumulates an experience and insight denied to others. Had the Commission, acting upon its experience and peculiar competence, promulgated a general rule of which its order here was a particular application, the problem for our consideration would be very different. Whether and to what extent directors or officers should be prohibited from buying or selling stock of the corporation during its reorganization, presents problems of policy for the judgment of Congress or of the body to which it has delegated power to deal with the matter. Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions unconcerned with the fairness of a particular transaction. But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respond-

ents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions. Nor has the Commission, acting under the rule-making powers delegated to it by § 11(e), promulgated new general standards of conduct."

No reason is given by the Commission in its brief why these passages from this Court's opinion should not have been deemed controlling upon the Commission following remand. The Commission's brief shows by asterisks (p. 27) the omission of the sentence: "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards—either the courts or Congress or an agency to which Congress has delegated its authority."

This Court said (R. 110):

"It is not for us to determine independently what is 'detrimental to the public interest or the interest of investors or consumers' or 'fair or equitable' within the meaning of §§ 7 and 11 of the Public Utility Holding Company Act of 1935."

The Commission refers to this statement (p. 29) as a declaration "that the Court could not assume for itself the Commission's duty of determining whether the management's activities were detrimental to the investor interests or unfair and inequitable in contravention of the standards of Sections 7 and 11 of the Act." It is manifest that the Court could not have affirmed the power of the Commission to reach the result which it did unless it determined the meaning of the statutory phrases upon which the Commission

relied as the source of its power. The word "independently" means that the Court did not consider it to be its duty to determine what the statutory standards meant until after the Commission had given its interpretation of the statutory standards.

The next sentence in this Court's opinion (R. 110):

"The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order as an appropriate safeguard for the interests protected by the Act."

the Commission translates in its brief as follows (p. 29):

"Speaking negatively—because the Commission had not stated the necessary findings and considerations—this Court indicated that the Commission's order might have been upheld if findings had been made and considerations disclosed, "which would justify its order as an appropriate safeguard for the interests protected by the Act."

The Court's statement meant merely that having determined to confine its review to the question of law which the Court said was presented, it was expressly disclaiming intruding its judgment upon any matter which the Commission might deem to be before it following remand.

The Commission quotes (pp. 30-31) the following:

"In finding that the Commission's order cannot be sustained, we are not imposing any trammels on its powers. We are not enforcing formal requirements. We are not suggesting that the Commission must justify its exercise of administrative discretion in any particular manner or with artistic refinement. We are not sticking in the bark of words. We

merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained."

This passage, of course, does not help the Commission in its attempt to use the opinion of this Court affirmatively as sustaining its power to reach the result which it reached by changing its opinion. In fact these words are inconsistent with such an interpretation as it certainly would be dignifying form over substance if the meaning of the opinion was that because the Commission cited equity precedents in support of the policy set forth in its opinion of March 24, 1941, that opinion could not be sustained, but if the Commission had omitted reference to equity precedents and had referred to its administrative competence, the order could be sustained. This in our view would be "sticking in the bark of words".

The grounds upon which the Commission acted in the present case were that the interveners had violated their fiduciary duties in purchasing preferred stock while a plan of reorganization was on file with the Commission. The only standard of fiduciary duty which was in existence was that established by courts of equity. The Commission had not exercised its administrative competence in promulgating a rule establishing a new standard of fiduciary duty or a new policy with respect to officers' and directors' purchases which had been violated. Accordingly, the order of the Commission could not be sustained.

FIFTH

THE GROUNDS UPON WHICH THE COMMISSION BASED ITS DECISION WERE PERTINENT TO AN INQUIRY AS TO THE ADVISABILITY OF PROMULGATING A RULE WITH RESPECT TO OFFICERS' AND DIRECTORS' PURCHASES OF STOCK. THEY AFFORD NO BASIS FOR THE COMMISSION'S ADMINISTRATIVE DECISION DISPOSING OF THE INTERVENERS' PROPERTY AND DENYING FEDERAL WATER AND GAS CORPORATION'S APPLICATION FOR LEAVE TO AMEND THE MERGER AGREEMENT.

In Point II of the Commission's brief, the Commission attempts to support its present decision upon the ground that the findings disclose "a rational and competent exercise of its administrative discretion in the application of the statutory standards." There is no discussion by the Commission of the standard "fair and equitable" in Section 11(c) or "detrimental to the public interest or the interest of investors or consumers" in Section 7. The Commission states (p. 36) that it deemed it necessary to exercise fully for the protection of investors the powers which Congress had given it to supervise the reorganization process in order to eliminate detrimental practices in reorganization and, in the words of the Committee report, to "make it impossible for a group of favored insiders to continue their domination over inarticulate and helpless minorities, or even as is often the case, majorities." (S. Report No. 621, 74th Cong., 1st Sess. p. 33; R. 152).

The basis for the Commission's decision is that it considered the purchase of stock by officers and directors and controlling stockholders after the corporation had filed a plan with the Commission when followed by an increase in

value above cost, was a detrimental practice prejudicial to investors.

Section 7 authorizes registered holding companies and subsidiaries to file declarations with the Commission in such form as the Commission may "by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers".

Section 11(e) authorizes registered holding companies and subsidiaries to submit plans to the Commission "in accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers."

It is apparent that what the Commission is attempting to do in this case is to take action by administrative decision which, if taken at all, should be taken by rule or order governing the filing of applications and declarations under Sections 7 and 11(e).

The Commission contends that the question whether the Commission has been authorized to take action with respect to officers' and directors' purchases of stock by rule or administrative decision is not a proper subject for judicial review. The Commission says (pp. 57-58):

"Since the Commission and not the court below had the responsibility of deciding whether to restrict itself to laying down standards applicable to future cases or whether it should apply the fair and equitable standard to limit the management's purchases to cost in this case, we submit that the reversal of the Commission's order by the court below was an improper substitution of that court's judgment for the judgment of the Commission."

If Congress had expressly authorized the Commission to take action by rule with respect to officers' and directors' purchases, it would not be contended that the Commission had authority to exercise the delegated power by administrative decision. The Commission here is seeking to exercise an implied power which this Court held had been conferred upon the Commission by the Holding Company Act. Every reason of justice and fair play supports the view that the implied power be held to be one to act by rule or order having prospective operation rather than by rule or order outlawing transactions in a reorganization which did not fall under the ban of any standard of conduct.

The question is one of construction of the Holding Company Act. And where Congress did not indicate that it had any policy at all with respect to officers' and directors' purchases of stock except that set forth in Section 17, it would seem that the formulation of a policy in this regard must be in pursuance of delegated legislative power. The difference between legislative and judicial action is well established. In *Prentiss v. Atlantic Coast Line*, 211 U. S. 210, this Court said (p. 226):

"A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power."

Because of the refusal of the Commission to recognize that there is any difference between its power to act in a legislative capacity for the protection of investors against possibilities which the Commission considered to be inherent

in the purchase of stock by officers and directors and controlling stockholders and its power to act in a quasi-judicial capacity in passing upon the fairness and equity of Federal Water and Gas Corporation's proposal to amend the merger agreement, the Commission made a most extraordinary administrative decision. The Commission relied upon what other companies could or might do as a justification for its order taking the property of the interveners and giving it to the corporation for the benefit of other stockholders. Of course, the Commission could rely upon what other companies did in justification for legislative action of the so-called "root and branch" type. See opinion of Judge Learned Hand in *Morgan Stanley & Co. v. Securities Exchange Commission*, 126 F. (2d) 325, 332, cited by this Court in its opinion (R. 108). But to refer to what other companies did or might do in a quasi-judicial decision disposing of the interveners' property was beyond the pale of reasonable administrative action.

So also, the decision makes the most extraordinary use of the principle of "official notice". To a limited extent, an administrative agency can rely upon facts which have come to its attention and about which there cannot be any reasonable dispute, even though they are not in the record. Even this authority has been limited by the recent "Administrative Procedure Act", which provides (Section 7(d)):

"Where any agency discretion rests on official notice of a material fact not appearing in the evidence and the record, any party shall on timely request be afforded an opportunity to show the contrary."

But the facts referred to by the Commission as providing the setting (R. 156) by which the Commission should judge

the rights of the interveners are not of the character of which administrative bodies can take official notice. Upon their face they appear to be imaginary possibilities which have been conjured up by the writer of the opinion to meet the exigencies of this case. The phrase "administrative experience" connotes actual happenings that have come to the attention of the Commission, and unless the conclusions are based upon facts they are not based upon "experience."

To take one example: the facts in this record support the conclusion that the officers and directors of Federal Water Service Corporation had no power whatever to put through a reorganization unless it was satisfactory to the Commission and they had no power to influence the Commission in the slightest degree as to "the ultimate allocation of new securities among the various existing classes." Nevertheless, the Commission, without the support of any facts in the record, states in its opinion (R. 156):

"The combination of these multiple powers in the management while a reorganization is under consideration places at its command a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute."

This, of course, is mere rhetoric and as applied to the facts in this case is unfair rhetoric and illegal rhetoric because it purports to be based upon private information which the Commission has not placed in the record (*Interstate Com-*

merce Commission v. Louisville & Nashville R. R. Co., 227 U. S. 88, 91, 93; *Chicago Junction Case*, 264 U. S. 258, 263.

With respect to the Class B stock it may be noted that prior to November 8, 1937, and at all subsequent times, it was clear to the Commission and its staff that the Class B stock did not wish to use its voting power in order to obtain for the Class B stock any interest in assets or earnings. The purpose of the capital reduction plan, which the Class B stock at all times was desirous of voting for, was to pay dividends upon the preferred stock, leaving the relative rights of the preferred stock, Class A stock and Class B stock unchanged and the Commission's powers under Section 11(b) unimpaired. In view of this attitude of the Class B stock, it seems particularly out of place for the Commission in its brief (p. 41) to include the following footnote:

"The Commission noted that many unsupervised reorganizations have been accomplished by first stopping dividends and starving the non-voting preferred stock to the point of desperation, then wielding the voting power of the junior stock as a weapon to force ultimate reorganization on terms unduly favorable to the latter. The management of a holding company is in a peculiarly strategic position to know the meaning of the non-payment of dividends, and what can be done to remove blocks in the flow of earnings from subsidiaries" (R. 156, Note 24).

It is true that this was said with respect to a power that management *could* exercise and it is not stated that the Class B stock in the present case *did* exercise it. But this only goes to show that the so-called "setting" in which the Commission judged the rights of the interveners was not a

"setting" at all. The findings in the opinion purporting to be based upon its administrative experience were appropriate to an inquiry as to the desirability of new legislation prohibiting innocent as well as guilty transactions, but could not be used in a judicial determination of the interveners' rights.

The Court of Appeals correctly stated the facts in the record as follows (R. 174):

"Accordingly, we had then, as we have now, a case in which there is not one jot or tittle of evidence tending to contradict petitioners' declared purpose in the purchase of preferred stocks to be the transfer of their interest from one class, declared by the Commission to be worthless, to another with voting rights, in order that to some extent they might make, as they thought, a safe investment and at the same time preserve some interest in a company to which they had devoted a considerable part of their business lives."

It is submitted that the right of the interveners to be treated in the reorganization on the same basis as other stockholders was protected by the Constitution and the Public Utility Holding Company Act. It was not left by Congress to the discretion of the Commission. If, however, this Court should hold otherwise; if the action of the Commission is in an area where Congress gave to the Commission discretion, such discretion, it is submitted, cannot be exercised arbitrarily or capriciously. There are no facts in the record which justified the Commission's order. And a decision without facts to support it is arbitrary.

CONCLUSION

The judgment of the Court of Appeals for the District of Columbia should be affirmed.

Respectfully submitted,

ALLEN S. HUBBARD

*Attorney for Federal Water and
Gas Corporation*

HUGHES, HUBBARD & EWING
New York, N. Y.

December, 1946.

APPENDIX OF STATUTES AND RULES

Public Utility Holding Company Act of 1935 49 Stat. 803, 15 U. S. C. Sec. 79

NECESSITY FOR CONTROL OF HOLDING COMPANIES

SECTION 1. * * *

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 88 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the State having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated becomes persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate com-

merce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

) * * *

UNLAWFUL SECURITY TRANSACTIONS BY REGISTERED HOLDING AND SUBSIDIARY COMPANIES

SEC. 6. (a) Except in accordance with a declaration effective under section 7 and with the order under such section permitting such declaration to become effective, it shall be unlawful for any registered holding company or subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, directly or indirectly (1) to issue or sell any security of such company; or (2) to exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of such company.

* * *

DECLARATIONS BY REGISTERED HOLDING AND SUBSIDIARY COMPANIES IN RESPECT OF SECURITY TRANSACTIONS

SEC. 7. (a) A registered holding company or subsidiary company thereof may file a declaration with the Commission, regarding any of the acts enumerated in subsection (a) of section 6, in such form as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers. Such declaration shall include—

(1) such of the information and documents which are required to be filed in order to register a security under section 7 of the Securities Act of 1933, as amended, as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers; and

(2) such additional information, in such form and detail, and such documents regarding the declarant or any associate company thereof, the particular security and compliance with such State laws as may apply to the act in question as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers.

(b) A declaration filed under this section shall become effective within such reasonable period of time after the filing thereof as the Commission shall fix by rules and regulations or order, unless the Commission prior to the expiration of such period shall have issued an order to the declarant to show cause why such declaration should become effective. Within a reasonable time after an opportunity for hearing upon an order to show cause under this subsection, unless the declarant shall withdraw its declaration, the Commission shall enter an order either permitting such declaration to become effective as filed or amended, or refusing to permit such declaration to become effective. Amendments to a declaration may be made upon such terms and conditions as the Commission may prescribe.

(c) The Commission shall not permit a declaration regarding the issue or sale of a security to become effective unless it finds that—

(1) such security is (A) a common stock having a par value and being without preference as to dividends

or distribution over, and having at least equal voting rights with, any outstanding security of the declarant;

* * *

(d) If the requirements of subsections (c) and (g) are satisfied, the Commission shall permit a declaration regarding the issue or sale of a security to become effective unless the Commission finds that—

* * *

(6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers.

(e) If the requirements of subsection (g) are satisfied, the Commission shall permit a declaration to become effective regarding the exercise of a privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security unless the Commission finds that such exercise of such privilege or right will result in an unfair or inequitable distribution of voting power among holders of the securities of the declarant or is otherwise detrimental to the public interest or the interest of investors or consumers.

(f) Any order permitting a declaration to become effective may contain such terms and conditions as the Commission finds necessary to assure compliance with the conditions specified in this section.

(g) If a State commission or State securities commission, having jurisdiction over any of the acts enumerated in subsection (a) of section 6, shall inform the Commission, upon request by the Commission for an opinion or otherwise, that State laws applicable to the act in question have not been complied with, the Commission shall not permit a declaration regarding the act in question to become effective

until and unless the Commission is satisfied that such compliance has been effected.

SIMPLIFICATION OF HOLDING-COMPANY SYSTEMS

SEC. 11. (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary compa-

nies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

(c) Any order under subsection (b) shall be complied with within one year from the date of such order; but the Commission shall, upon a showing (made before or after the entry of such order) that the applicant has been or will be unable in the exercise of due diligence to comply with such order within such time, extend such time for an additional period not exceeding one year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers.

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission

as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (a) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provision of such plan. If, upon any such application, the court, after notice

and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

* * *

(g) It shall be unlawful for any person to solicit or permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, consent, authorization, power of attorney, deposit, or dissent in respect of any reorganization plan of a registered holding company or any subsidiary company thereof under this section, or otherwise, or in respect of any plan under this section for the divestment of control, securities, or other assets, or for the dissolution of any registered holding company or any subsidiary company thereof, unless—

(1) the plan has been proposed by the Commission, or the plan and such information regarding it and its sponsors as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers has been submitted to the Commission by a person having a bona fide interest (as defined by the rules and regulations of the Commission) in such reorganization;

(2) each such solicitation is accompanied or preceded by a copy of a report on the plan which shall be made by the Commission after an opportunity for a

hearing on the plan and other plans submitted to it, or by an abstract of such report made or approved by the Commission; and

(3) each such solicitation is made not in contravention of such rules and regulations or orders as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers.

Nothing in this subsection or the rules and regulations thereunder shall prevent any person from appearing before the Commission or any court through an attorney or proxy.

* * *

(e) It shall be unlawful for any person to solicit or to permit the use of his or its name to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, power of attorney, consent, or authorization regarding any security of a registered holding company or a subsidiary company thereof in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder.

OFFICERS, DIRECTORS, AND OTHER AFFILIATES

SEC. 17. (a) Every person who is an officer or director of a registered holding company shall file with the Commission in such form as the Commission shall prescribe (1) at the time of the registration of such holding company, or within ten days after such person becomes an officer or director, a statement of the securities of such registered holding company or any subsidiary company thereof of which he is, directly or indirectly, the beneficial owner, and (2) within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, a statement of such ownerships as of the

close of such calendar month and of the changes in such ownership that have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by any such officer or director by reason of his relationship to such registered holding company or any subsidiary company thereof, any profit realized by any such officer or director from any purchase and sale, or any sale and purchase, of any security of such registered holding company or any subsidiary company thereof within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the holding company or subsidiary company in respect of the security of which such profit was realized, irrespective of any intention on the part of such officer or director in entering into such transaction to hold the security purchased or not to repurchase the security sold for a period of more than six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the company entitled thereto or by the owner of any security of such company in the name and in the behalf of such company if such company shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not cover any transaction where such person was not an officer or director at the times of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may, as necessary or appropriate in the public interest or for the protection of investors or consumers, exempt as not comprehended within the purpose of this subsection. Nothing in this subsection shall be construed to give a remedy in the case of any transaction in respect of which a remedy is given under subsection (b) of section 16 of the Securities Exchange Act of 1934.

RULES, REGULATIONS, AND ORDERS

SEC. 20. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title, including rules and regulations defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form or forms in which information required in any statement, declaration, application, report, or other document filed with the Commission shall be set forth, the items or details to be shown in balance sheets, profit and loss statements, and surplus accounts, the manner in which the cost of all assets, whenever determinable, shall be shown in regard to such statements, declarations, applications, reports, and other documents filed with the Commission, or accounts required to be kept by the rules, regulations, or orders of the Commission, and the methods to be followed in the keeping of accounts and cost-accounting procedures and the preparation of reports; in the segregation and allocation of costs, in the determination of liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the keeping or preparation, where the Commission deems it necessary or appropriate of separate or consolidated balance sheets or profit and loss statements for any companies in the same holding-company system.

* * *

(d) * * * No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

Rules of the Commission in Effect June 1, 1938, Code of Federal Regulations, Title 17, p. 1084, Et Seq.

250.0-4. Reservation of constitutional or legal rights.

(a) Any person filing, signing, or certifying to, any notification, statement, application, declaration, report, or other document pursuant to the Act, the rules and regulations, or any order of the Commission under the Act or the rules and regulations in this part, may include therein in behalf of such person or of any other person affected thereby an express reservation of, and refusal to waive, any constitutional or legal rights. If the reservation or refusal to waive asserted by or on behalf of any such person or persons shall be held invalid or inoperative by any court of competent jurisdiction, such filing, signing, or certifying may, at the option of any such person or persons, be deemed to have been void and of no effect from any date specified in written notice given to the Commission, by or in behalf of such person or persons, except that the validity of transactions which otherwise might be impaired by reason of the voidance and ineffectiveness of such filing, signing or certifying, shall not be effected thereby.

(b) The acceptance of any order, rule, or regulation, or the compliance with any provision of the Act, of the rules and regulations, or of any order or direction of the Commission shall not be deemed a waiver of any constitutional or legal rights. [Rule U-4]

* * *

250.12e-4. Applications for reports on plans.

(a) Any person having a bona fide interest (as defined by §250.12e-1) in a reorganization of a registered holding company or a subsidiary of such a company may apply to the Commission for a report on a reorganization plan for such company which such person has submitted to the Commission in writing. Any number of persons may join in such an application. Every such application shall comply with the provisions of §250.0-2 as to number of copies, form and

execution. In addition to giving the name and address of each applicant for such report, every such application shall set forth the name and address of the person to whom the Commission should address correspondence with respect to such application; the name and address of the company to be reorganized; and the nature of the bona-fide interest of each applicant in the proposed reorganization. A copy of the plan and of the reorganization agreement (if any) should be attached as exhibits. Insofar as applicable to the situation, each such application should also contain—

(1) A description of any proceedings before a court or other governmental body in connection with such reorganization, giving the date when such proceedings were instituted and describing briefly the history and present status thereof;

(2) (i) Financial statements of the company and its subsidiaries as of the most recent date available,

(ii) Earnings and surplus statements of the company and its subsidiaries as shown by their books for the 5 fiscal years next preceding the date of the application,

(iii) Pro forma balance sheets and earnings statements giving effect to the proposed transactions and to any adjustments proposed to be made in the accounts of the reorganized company;

(3) A brief description of the classes, amounts and rights of the owners of securities and of any substantial undisputed claims against such company, and of all changes in such rights to be effected by such plan;

(4) A statement as to the nature of any substantial presently existing claims or actions (i) against the company and (ii) on behalf of the company or the holders of its securities against any other person, (other than those referred to in paragraph (3)), and as to the results of any investigations made by or for the applicants and of any

significant investigations by courts, trustees, State commissions, or other bodies or persons that are available to applicants concerning the existence and validity of such claims, and the recommendations of the applicants with respect to the appropriate action to be taken in connection therewith;

(5) A statement of the nature and results of any important investigations made by or for the applicants as to the recent or present condition, adequacy or efficiency of the properties, operations, rates, management, accounting practices, depreciation, financial and other policies of such company and its subsidiaries; a statement of any important changes in such respects that are expected to result from or to follow the proposed reorganization; and a citation of any important public or private reports on any such matters that are known by the applicants to have been made within 5 years prior to the filing of the application;

(6) A statement of the reasons why the present is deemed to be an appropriate time to effect the proposed reorganization;

(7) A statement as to the history of the formulation and negotiation of the plan and the reasons why the applicants deem it to be fair and equitable, including a statement as to the estimates of future earnings and requirements of further capital for improvements, extensions and other corporate purposes that were used in formulating the plan; the reasons for selecting the types of new securities to be issued and the consideration that has been given to the requirements of paragraphs (c) and (d) of section 7 (49 Stat. 815, 816; 15 U. S. C., Sup., 79g (c), (d)); the principles on which such securities were allocated among the owners of outstanding securities and claims; and the extent to which such plan will effect or aid in the ultimate simplification of the corporate structure of the holding company system of which such company is a member and in carrying out the other purposes of section 11 (b) (49 Stat. 820; 15 U. S. C., Sup., 79k (b));

(8) A comprehensive statement giving the names and addresses of all persons (including, in the case of a company plan, the officers and directors of such company) who were primarily responsible for the preparation and negotiation of the plan and the class of securities or claims represented by each, the names and addresses of the persons at whose request or on whose behalf each such negotiator was acting and the names of their important legal, accounting, engineering and financial advisers, all important relations now existing or which have existed within 5 years prior to the date of such application between all such persons and the company to which the plan relates, every subsidiary thereof and every company of which it is a subsidiary, whether as officers, directors, underwriters or otherwise (if any such person does not purport to be an independent representative of a single class of securities or claims, a general statement of his position and relationships may be substituted for the data above specified in this subparagraph); the amounts of each class of securities of and claims against each such company that were beneficially owned by each such person as of a date not more than 20 days prior to the filing of the application, and a list, by individuals, giving the applicant's best information as to all purchases and all sales of such securities, within a period of 3 years prior to the filing of the application, in which any such person had a beneficial interest, the prices at which each such purchase and sale was made and a statement as to the nature of the investigations made in connection with the preparation of such list and the basis for the information therein contained;

(9) A statement as to the amounts that each person described in subparagraph (8) (including attorneys and other principal advisers) have already received as compensation and expenses for their services in connection with such reorganization and solicitation; the principles or bases on which further compensation of such persons will be determined, including, in so far as practicable, the rates

per hour or per day that will be charged or requested for the services of such persons and the respective classes of their employees, together with estimates of the maximum amount of time such respective classes of service will consume; the sources from which such compensation has been, and such further compensation is to be received; a statement of any agreements or understandings between firms of attorneys, accountants or other experts with respect to division of their respective fees; a statement as to whether the amounts of any further compensation are to be subject to determination or review by any court, governmental agency or independent person; and a statement of all agreements, understandings, or arrangements that have been entered into by or with any such person, his attorneys or other principal advisers with respect to future employment, underwritings and similar matters: Provided, That in the case of a plan of reorganization to be submitted by a company to its security holders, which is not proposed in connection with or in anticipation of any court proceeding, estimates in reasonable detail, showing the aggregate fees and expenses to be incurred in connection with such plan may be substituted in lieu of the above information;

(10) The names and addresses of any committees and any holders of substantial amounts of securities or claims who have indicated opposition to the proposed plan;

(11) A statement as to the willingness of the applicants to mail notice of the Commission's public hearing on the application to the holders of securities and claims affected by the plan, and as to the access of the applicants to lists of holders of any such securities payable to bearer; and

(12) Such other and further information as the Commission may require to be supplied by amendment. Attach as an exhibit an opinion of counsel stating whether any courts, State commissions or other governmental bodies are required to pass upon the transactions to be carried out

pursuant to the proposed plan, giving the status of any proceedings then pending before any such bodies and expressing an opinion as to whether, upon the taking of specified further steps, the plan will become binding upon owners of securities of and claims against the company, who do not consent thereto. Such opinion shall cite the relevant constitutional, statutory and charter provisions and the controlling court decisions, if any, with respect to the jurisdiction of such bodies and with respect to the conditions upon which the plan will become binding upon the owners of securities of and claims against the company who do not consent thereto.

(b) Any such application for a report on a reorganization plan may include as a part thereof such additional statements as are required by §250.12e-5, for a declaration by the applicants in respect of a solicitation of proxies, consents, dissents or requests for the deposit of securities, in connection with such plan and every application containing such statements shall be deemed to constitute both an application under this section and a declaration under said § 250.12e-5.

[Rule U-12E-4, effective July 26, 1937, 2 F. R. 1342]

SUPREME COURT OF THE UNITED STATES

NOS. 81 AND 82.—OCTOBER TERM, 1946.

Securities and Exchange Commission,
Petitioner,

81

v.

Chenery Corporation, et al.

Securities and Exchange Commission,
Petitioner,

82

v.

Federal Water and Gas Corporation.

On Writs of Cer-
tiorari to the
United States
Court of Ap-
peals for the
District of Co-
lumbia.

[June 23, 1947.]

MR. JUSTICE MURPHY delivered the opinion of the Court.

This case is here for the second time. In *S. E. C. v. Chenery Corp.*, 318 U. S. 80, we held that an order of the Securities and Exchange Commission could not be sustained on the grounds upon which that agency acted. We therefore directed that the case be remanded to the Commission for such further proceedings as might be appropriate. On remand, the Commission reexamined the problem, recast its rationale and reached the same result. The issue now is whether the Commission's action is proper in light of the principles established in our prior decision.

When the case was first here, we emphasized a simple but fundamental rule of administrative law. That rule is to the effect that a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action

by substituting what it considers to be a more adequate or proper basis. To do so would propel the court into the domain which Congress has set aside exclusively for the administrative agency.

We also emphasized in our prior decision an important corollary of the foregoing rule. If the administrative action is to be tested by the basis upon which it purports to rest, that basis must be set forth with such clarity as to be understandable. It will not do for a court to be compelled to guess at the theory underlying the agency's action; nor can a court be expected to chisel that which must be precise from what the agency has left vague and indecisive. In other words, "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." *United States v. Chicago, M., St. P. & P. R. Co.*, 294 U.S. 499, 511.

Applying this rule and its corollary, the Court was unable to sustain the Commission's original action. The Commission had been dealing with the reorganization of the Federal Water Service Corporation (Federal), a holding company registered under the Public Utility Holding Company Act of 1935; 49 Stat. 803. During the period when successive reorganization plans proposed by the management were before the Commission, the officers, directors and controlling stockholders of Federal purchased a substantial amount of Federal's preferred stock on the over-the-counter market. Under the fourth reorganization plan, this preferred stock was to be converted into common stock of a new corporation; on the basis of the purchases of preferred stock, the management would have received more than 10% of this new common stock. It was frankly admitted that the management's purpose in buying the preferred stock was to protect its interest in the new company. It was also plain that there was no fraud or lack of disclosure in making these purchases.

But the Commission would not approve the fourth plan so long as the preferred stock purchased by the manage-

ment was to be treated on a parity with the other preferred stock. It felt that the officers and directors of a holding company in process of reorganization under the Act were fiduciaries and were under a duty not to trade in the securities of that company during the reorganization period. 8 S. E. C. 893, 915-921. And so the plan was amended to provide that the preferred stock acquired by the management, unlike that held by others, was not to be converted into the new common stock; instead, it was to be surrendered at cost plus dividends accumulated since the purchase dates. As amended, the plan was approved by the Commission over the management's objections. 10 S. E. C. 200.

The Court interpreted the Commission's order approving this amended plan as grounded solely upon judicial authority. The Commission appeared to have treated the preferred stock acquired by the management in accordance with what it thought were standards theretofore recognized by courts. If it intended to create new standards growing out of its experience in effectuating the legislative policy, it failed to express itself with sufficient clarity and precision to be so understood. Hence the order was judged by the only standards clearly invoked by the Commission. On that basis, the order could not stand. The opinion pointed out that courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock. Nor was it felt that the cases upon which the Commission relied established any principles of law or equity which in themselves would be sufficient to justify this order.

The opinion further noted that neither Congress nor the Commission had promulgated any general rule proscribing such action as the purchase of preferred stock by Federal's management. And the only judge-made rule of equity which might have justified the Commission's order related

to fraud or mismanagement of the reorganization by the officers and directors, matters which were admittedly absent in this situation.

After the case was remanded to the Commission, Federal Water and Gas Corp. (Federal Water), the surviving corporation under the reorganization plan, made an application for approval of an amendment to the plan to provide for the issuance of new common stock of the reorganized company. This stock was to be distributed to the members of Federal's management on the basis of the shares of the old preferred stock which they had acquired during the period of reorganization, thereby placing them in the same position as the public holders of the old preferred stock. The intervening members of Federal's management joined in this request. The Commission denied the application in an order issued on February 7, 1945. Holding Company Act Release No. 5584. That order was reversed by the Court of Appeals, 154 F. 2d 6, which felt that our prior decision precluded such action by the Commission.

The latest order of the Commission definitely avoids the fatal error of relying on judicial precedents which do not sustain it. This time, after a thorough reexamination of the problem in light of the purposes and standards of the Holding Company Act, the Commission has concluded that the proposed transaction is inconsistent with the standards of §§ 7 and 11 of the Act. It has drawn heavily upon its accumulated experience in dealing with utility reorganizations. And it has expressed its reasons with a clarity and thoroughness that admit of no doubt as to the underlying basis of its order.

The argument is pressed upon us, however, that the Commission was foreclosed from taking such a step following our prior decision. It is said that, in the absence of findings of conscious wrongdoing on the part of Federal's management, the Commission could not determine

by an order in this particular case that it was inconsistent with the statutory standards to permit Federal's management to realize a profit through the reorganization purchases. All that it could do was to enter an order allowing an amendment to the plan so that the proposed transaction could be consummated. Under this view, the Commission would be free only to promulgate a general rule outlawing such profits in future utility reorganizations; but such a rule would have to be prospective in nature and have no retroactive effect upon the instant situation.

We reject this contention, for it grows out of a misapprehension of our prior decision and of the Commission's statutory duties. We held no more and no less than that the Commission's first order was unsupportable for the reasons supplied by that agency. But when the case left this Court, the problem whether Federal's management should be treated equally with other preferred stockholders still lacked a final and complete answer. It was clear that the Commission could not give a negative answer by resort to prior judicial declarations. And it was also clear that the Commission was not bound by settled judicial precedents in a situation of this nature. 318 U. S. at 89. Still unsettled, however, was the answer the Commission might give were it to bring to bear on the facts the proper administrative and statutory considerations, a function which belongs exclusively to the Commission in the first instance. The administrative process had taken an erroneous rather than a final turn. Hence we carefully refrained from expressing any views as to the propriety of an order rooted in the proper and relevant considerations. See *Siegel v. Federal Trade Commission*, 327 U. S. 608, 613-614.

When the case was directed to be remanded to the Commission for such further proceedings as might be appropriate, it was with the thought that the Commission would give full effect to its duties in harmony with the views we

had expressed. *Ford Motor Co. v. Labor Board*, 305 U. S. 364, 374; *Federal Radio Commission v. Nelson Bros. Co.*, 289 U. S. 266, 278. This obviously meant something more than the entry of a perfunctory order giving parity treatment to the management holdings of preferred stock. The fact that the Commission had committed a legal error in its first disposition of the case certainly gave Federal's management no vested right to receive the benefits of such an order. See *Federal Communications Commission v. Pottsville Broadcasting Co.*, 309 U. S. 134, 145. After the remand was made, therefore, the Commission was bound to deal with the problem afresh, performing the function delegated to it by Congress. It was again charged with the duty of measuring the proposed treatment of the management's preferred stock holdings by relevant and proper standards. Only in that way could the legislative policies embodied in the Act be effectuated. /

The absence of a general rule or regulation governing management trading during reorganization did not affect the Commission's duties in relation to the particular proposal before it. The Commission was asked to grant or deny effectiveness to a proposed amendment to Federal's reorganization plan whereby the management would be accorded parity treatment on its holdings. It could do that only in the form of an order, entered after a due consideration of the particular facts in light of the relevant and proper standards. That was true regardless of whether those standards previously had been spelled out in a general rule or regulation. Indeed, if the Commission rightly felt that the proposed amendment was inconsistent with those standards, an order giving effect to the amendment merely because there was no general rule or regulation covering the matter would be unjustified.

It is true that our prior decision explicitly recognized the possibility that the Commission might have promulgated a general rule dealing with this problem under its statutory rule-making powers, in which case the issue for

our consideration would have been entirely different from that which did confront us. 318 U. S. 92-93. But we did not mean to imply thereby that the failure of the Commission to anticipate this problem and to promulgate a general rule withdrew all power from that agency to perform its statutory duty in this case. To hold that the Commission had no alternative in this proceeding but to approve the proposed transaction, while formulating any general rules it might desire for use in future cases of this nature, would be to stultify the administrative process. That we refuse to do.

Since the Commission, unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon *ad hoc* adjudication to formulate new standards of conduct within the framework of the Holding Company Act. The function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future. But any rigid requirement to that effect would make the administrative process inflexible and incapable of dealing with many of the specialized problems which arise. See Report of the Attorney General's Committee on Administrative Procedure in Government Agencies, S. Doc. No. 8, 77th Cong., 1st Sess., p. 29. Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations. In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rule or by individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity.

In other words, problems may arise in a case which the administrative agency could not reasonably foresee, prob-

lems which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem as warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards. And the choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency. See *Columbia Broadcasting System v. United States*, 316 U. S. 407, 421.

Hence we refuse to say that the Commission, which had not previously been confronted with the problem of management trading during reorganization, was forbidden from utilizing this particular proceeding for announcing and applying a new standard of conduct. Cf. *Federal Trade Commission v. Keppel & Bro.*, 291 U. S. 304. That such action might have a retroactive effect was not necessarily fatal to its validity. Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law. See *Addison v. Holly Hill Co.*, 322 U. S. 607, 620.

And so in this case, the fact that the Commission's order might retroactively prevent Federal's management from securing the profits and control which were the objects of the preferred stock purchases may well be out-

weighed by the dangers inherent in such purchases from the statutory standpoint. If that is true, the argument of retroactivity becomes nothing more than a claim that the Commission lacks power to enforce the standards of the Act in this proceeding. Such a claim deserves rejection.

The problem in this case thus resolves itself into a determination of whether the Commission's action in denying effectiveness to the proposed amendment to the Federal reorganization plan can be justified on the basis upon which it clearly rests. As we have noted, the Commission avoided placing its sole reliance on inapplicable judicial precedents. Rather it has derived its conclusions from the particular facts in the case, its general experience in reorganization matters and its informed view of statutory requirements. It is those matters which are the guide for our review.

The Commission concluded that it could not find that the reorganization plan, if amended as proposed, would be "fair and equitable to the persons affected thereby" within the meaning of § 11 (e) of the Act, under which the reorganization was taking place. Its view was that the amended plan would involve the issuance of securities on terms "detrimental to the public interest and the interest of investors" contrary to §§ 7 (d) (6) and 7 (e), and would result in an "unfair or inequitable distribution of voting power" among the Federal security holders within the meaning of § 7 (e). It was led to this result "not by proof that the interveners [Federal's management] committed acts of conscious wrongdoing but by the character of the conflicting interests created by the interveners' program of stock purchases carried out while plans for reorganization were under consideration."

The Commission noted that Federal's management controlled a large multi-state utility system and that its influence permeated down to the lowest tier of operating

companies. The financial, operational and accounting policies of the parent and its subsidiaries were therefore under the management's strict control. The broad range of business judgments vested in Federal's management multiplied opportunities for affecting the market price of Federal's outstanding securities and made the exercise of judgment on any matter a subject of greatest significance to investors. Added to these normal managerial powers, the Commission pointed out that a holding company management obtains special powers in the course of a voluntary reorganization under § 11 (e) of the Holding Company Act. The management represents the stockholders in such a reorganization, initiates the proceeding, draws up and files the plan, and can file amendments thereto at any time. These additional powers may introduce conflicts between the management's normal interests and its responsibilities to the various classes of stockholders which it represents in the reorganization. Moreover, because of its representative status, the management has special opportunities to obtain advance information of the attitude of the Commission.

Drawing upon its experience, the Commission indicated that all these normal and special powers of the holding company management during the course of a § 11 (e) reorganization placed in the management's command "a formidable battery of devices that would enable it, if it should choose to use them selfishly, to affect in material degree the ultimate allocation of new securities among the various existing classes, to influence the market for its own gain, and to manipulate or obstruct the reorganization required by the mandate of the statute." In that setting, the Commission felt that a management program of stock purchase would give rise to the temptation and the opportunity to shape the reorganization proceeding so as to encourage public selling on the market at low prices. No management could engage in such a program.

without raising serious questions as to whether its personal interests had not opposed its duties "to exercise disinterested judgment in matters pertaining to subsidiaries' accounting, budgetary and dividend policies, to present publicly an unprejudiced financial picture of the enterprise, and to effectuate a fair and feasible plan expeditiously."

The Commission further felt that its answer should be the same even where proof of intentional wrongdoing on the management's part is lacking. Assuming a conflict of interests, the Commission thought that the absence of actual misconduct is immaterial; injury to the public investors and to the corporation may result just as readily. "Questionable transactions may be explained away, and an abuse of investors and the administrative process may be perpetrated without evil intent, yet the injury will remain." Moreover, the Commission was of the view that the delays and the difficulties involved in probing the mental processes and personal integrity of corporate officials do not warrant any distinction on the basis of evil intent, the plain fact being "that an absence of unfairness or detriment in cases of this sort would be practically impossible to establish by proof."

Turning to the facts in this case, the Commission noted the salient fact that the primary object of Federal's management in buying the preferred stock was admittedly to obtain the voting power that was accruing to that stock through the reorganization and to profit from the investment therein. That stock had been purchased in the market at prices that were depressed in relation to what the management anticipated would be, and what in fact was, the earning and asset value of its reorganization equivalent. The Commission admitted that the good faith and personal integrity of this management were not in question; but as to the management's justification of its motives, the Commission concluded that it was

merely trying to "deny that they made selfish use of their powers during the period when their conflict of interest, *vis-a-vis* public investors, was in existence owing to their purchase program." Federal's management had thus placed itself in a position where it was "peculiarly susceptible to temptation to conduct the reorganization for personal gain rather than the public good" and where its desire to make advantageous purchases of stock could have an important influence, even though subconsciously, upon many of the decisions to be made in the course of the reorganization. Accordingly, the Commission felt that all of its general considerations of the problem were applicable to this case.

The scope of our review of an administrative order wherein a new principle is announced and applied is no different from that which pertains to ordinary administrative action. The wisdom of the principle adopted is none of our concern. See *Board of Trade v. United States*, 314 U. S. 534, 548. Our duty is at an end when it becomes evident that the Commission's action is based upon substantial evidence and is consistent with the authority granted by Congress. See *National Broadcasting Co. v. United States*, 319 U. S. 190, 224.

We are unable to say in this case that the Commission erred in reaching the result it did. The facts being undisputed, we are free to disturb the Commission's conclusion only if it lacks any rational and statutory foundation. In that connection, the Commission has made a thorough examination of the problem, utilizing statutory standards and its own accumulated experience with reorganization matters. In essence, it has made what we indicated in our prior opinion would be an informed, expert judgment on the problem. It has taken into account "those more subtle factors in the marketing of utility company securities that gave rise to the very grave evils which the Public Utility Holding Company

Act of 1935 was designed to correct" and has relied upon the fact that "Abuse of corporate position, influence, and access to information may raise questions so subtle that the law can deal with them effectively only by prohibitions not concerned with the fairness of a particular transaction." 318 U.S. at 92.

Such factors may properly be considered by the Commission in determining whether to approve a plan of reorganization of a utility holding company, or an amendment to such a plan. The "fair and equitable" rule of § 11 (e) and the standard of what is "detrimental to the public interest or the interest of investors or consumers" under § 7 (d) (6) and § 7 (e) were inserted by the framers of the Act in order that the Commission might have broad powers to protect the various interests at stake. 318 U.S. at 90-91. The application of those criteria, whether in the form of a particular order or a general regulation, necessarily requires the use of informed discretion by the Commission. The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters. See *United States v. Lowden*, 308 U. S. 225; *I. C. C. v. Railway Labor Assn.*, 315 U. S. 373. Such an abuse is not present in this case.

The purchase by a holding company management of that company's securities during the course of a reorganization may well be thought to be so fraught with danger as to warrant a denial of the benefits and profits accruing to the management. The possibility that such a stock purchase program will result in detriment to the public investors is not a fanciful one. The influence that program may have upon the important decisions to be made by the management during reorganization is not inconsequential. Since the officers and directors occupy fiduciary positions during this period, their actions are to be held to a higher standard than that imposed upon the

general investing public. There is thus a reasonable basis for a value judgment that the benefits and profits accruing to the management from the stock purchases should be prohibited, regardless of the good faith involved. And it is a judgment that can justifiably be reached in terms of fairness and equitableness, to the end that the interests of the public, the investors and the consumers might be protected. But it is a judgment based upon public policy, a judgment which Congress has indicated is of the type for the Commission to make.

The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See *Republic Aviation Corp. v. Labor Board*, 324 U. S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb.

Reversed.

MR. JUSTICE BURTON concurs in the result.

THE CHIEF JUSTICE and MR. JUSTICE DOUGLAS took no part in the consideration or decision of these cases.

MR. JUSTICE FRANKFURTER and MR. JUSTICE JACKSON dissent, but there is not now opportunity for a response adequate to the issues raised by the Court's opinion. These concern the rule of law in its application to the administrative process and the function of this Court in reviewing administrative action. Accordingly, the detailed grounds for dissent will be filed in due course.